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February 21, 1986

To: Members of the Executive Board

From: The Acting Secretary

Subject: Argentina - Staff Report for the 1985 Article IV Consultation and Review of Stand-By Arrangement

Attached for consideration by the Executive Directors is the staff report for the 1985 Article IV consultation with Argentina and a review of its stand-by arrangement. Draft decisions appear on pages 30-33.

It is understood that the Executive Director elected by Argentina will be requesting the Board for a waiver of the circulation period, to enable this subject to be brought to the agenda for discussion on Monday, March 10, 1986.

Mr. Ferrân (ext. 8632) or Mr. Stuart (ext. 8602) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

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INTERNATIONAL MONETARY FUND

ARGENTINA

Staff Report for the 1985 Article IV Consultation and Review of Stand-by Arrangement

Prepared by the Western Hemisphere and the Exchange and Trade Relations Departments

(In consultation with the Fiscal Affairs, Legal and Treasurer's Departments)

Approved by E. Wiesner and Manuel Guitián

February 20, 1986

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I. Introduction

Article IV consultation discussions with Argentina 1/ were held in Buenos Aires in the period August 28-September 20 and October 29-December 4, 1985, in conjunction with discussions on the second review of the stand-by arrangement approved on December 28, 1984; these discussions were completed during visits of Argentine officials to Fund headquarters in the period December 1985-February 1986. 2/ In the attached letter, the Minister of Economy and the President of the Central Bank of Argentina set forth the policies for the remaining period of the stand-by arrangement, propose an extension of the period of the arrangement to the end of May 1986, and request a waiver for performance criteria that have not been observed. The review had been scheduled for completion by the end of October 1985, but delays were incurred which prevented the setting of certain performance criteria for end-1985. As policies remained unspecified for a significant period of the arrangement, it is proposed (as noted in the attached letter) that the amount of the stand-by arrangement be reduced from SDR 1,419 million to SDR 1,182.5 million, that is, by the equivalent of the purchase that would have been available upon end-December 1985 performance; accordingly, there would remain two purchases of SDR 236.5 million each, one upon conclusion of the second review and the other after May 20, 1986 (Table 1).

The last Article IV consultation with Argentina was concluded by the Executive Board on September 4, 1984 (EBM/84/132 and EBM/84/133). In those meetings, Executive Directors noted the difficult economic situation confronted by the Constitutional Government which took office in December 1983, and recommended to the authorities that they take prompt action to bring inflation under control. They stressed that an effective anti-inflation strategy would have to center on a policy of monetary restraint supported by a large reduction in the fiscal deficit; in addressing the fiscal problem, emphasis should be put on expenditure cuts, and interest rates should be positive in real terms. Directors observed that the rate of increase of nominal wages would need to come down, and drew attention to the risks involved in maintaining rigid price controls for prolonged periods. Given Argentina's high external

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1/ Argentina has accepted the obligations of Article VIII, Section 2, 3, and 4, of the Articles of Agreement.

2/ During the visits to Buenos Aires, the staff met with the Ministers of Economy, Labor, and Public Works and Services; the Secretaries of Economic Coordination, Finance, Industry, External Trade, Internal Trade, Planning, Growth Promotion, and Social Security; and senior officials of the Central Bank, other official banks, and government agencies. Mr. F. Nebbia, Executive Director for Argentina, participated in some of the meetings. The staff team in the discussions included Messrs. J. Ferrán, B. Stuart, J. Braz, and C. Collyns (WHD), D. Lipton and J. Berengaut (ETR), and J. Tavares and A. Antonaya (FAD); secretaries of the two missions to Buenos Aires were Miss P. Edwards and Miss A. M. Eyzaguirre (WHD).

debt, Directors said that reliance on foreign debt financing should be limited, and that the balance of payments deficit should be reduced over time, especially by improving export performance. Exchange rate policy would need to be geared to the strengthening of the balance of payments in the context of a major liberalization of the exchange and trade system, including the elimination of external payments arrears.

In late September 1984, Argentina adopted an economic program to deal forcefully though gradually with the country's problems, and on December 28, 1984 (EBM/84/191) the Executive Board approved a 15-month stand-by arrangement for SDR 1,419 million in support of that program. After a substantial adjustment effort in the fourth quarter of 1984, the program moved off track in the early part of 1985, and inflation intensified. On June 14, 1985, the authorities announced a frontal attack on inflation, based on a reduction in the fiscal deficit which was expected to obviate the need for any domestic financing of the public sector, a major tightening of credit policy, and a monetary reform. The revised program also included the fixing of the exchange rate vis-a-vis the U.S. dollar (following a sizable exchange rate adjustment), and a temporary wage-price freeze to break wage-price indexation. These measures were incorporated in the first review of the stand-by arrangement, which was concluded by the Executive Board on August 9, 1985 (EBM/85/124 and EBM/85/125).

II. Recent Economic Developments and Performance Under the 1984 Stand-By Arrangement

The economic program developed in September 1984 was based on the view that a lasting improvement in the economic performance of Argentina would not be possible unless inflation was brought under control and external imbalances corrected. To achieve these aims, the program envisaged a tightening of financial policies, a slowing in the rate of increase in nominal wages, and a reversal of the real appreciation of Argentina's currency that had occurred since 1983. Success in reducing inflation and restoring external viability--together with corrections of relative prices, a reduction of public sector spending, and a liberalization of the trade and payments system--was expected to produce an environment conducive to a recovery of private fixed investment and sustained economic growth. (Selected economic and financial indicators and data on growth performance and fixed capital formation in the past several years are presented in Tables 2 and 3, respectively.)

In the fourth quarter of 1984, credit policy was tightened and real interest rates (measured in relation to the actual increase in the price indices) rose sharply (Chart 1). An effort also was made to contain government spending and the public sector deficit, but to an extent this objective was pursued by postponing payments rather than by curbing commitments. Progress was made in correcting relative prices--public sector prices in real terms were raised, price controls were relaxed, and there was a substantial real depreciation of the currency. The spread between the official and parallel exchange rates came down markedly, and there were large capital inflows from abroad. Inflation slowed but remained higher than had been projected--in part reflecting a sizable wage adjustment decreed by the Government in early October that had not been contemplated in the program--and the performance criteria expressed in local currency terms for end-1984 were not observed, although in most cases the deviations were small (Table 4).

The stabilization effort was not sustained in the first quarter of 1985. Monetary and credit policy was eased, and regulated interest rates again were well below the rate of inflation. Public sector spending and the fiscal deficit rose sharply, owing, inter alia, to wage increases in excess of those consistent with the inflation objectives of the program. The monthly rate of inflation--as measured by the average of the consumer and wholesale price indices--picked up to 27 percent in March 1985 from an average of 18 percent in the fourth quarter of 1984, and the end-March 1985 performance criteria expressed in local currency were exceeded by wide margins (see Table 4). The general relaxation of policy also led to a weakening of net capital inflows from abroad, and the overall balance of payments deficit widened to nearly US$1 billion in the first quarter of 1985. The slackening of industrial activity that had begun about mid-1984 intensified in the early part of 1985 (Chart 2).

As the economic and financial situation worsened, beginning in May 1985 the authorities tightened monetary policy and took a series of measures to strengthen the fiscal position and the balance of payments. In particular, prices of goods sold by public enterprises in real terms were raised substantially in May-early June, following a period in which such prices had tended to decline, and there was a real depreciation of the currency. To facilitate the change in relative prices that was being sought, each month the general increase in wages decreed by the Government was limited to 90 percent of the rise in consumer prices in the previous month, with no provision for catch-up wage increases. 1/ Prices continued to accelerate, with the average monthly rate of inflation in the second quarter reaching 32 percent, and in June 1985 prices were about 1,100 percent higher than one year before (Chart 4); however, the price acceleration reflected in part corrective adjustments which set the stage for the attack on inflation announced on June 14, 1985.

As explained in their letter of July 22, 1985, the Argentine authorities had come to the view that it would be extremely difficult to carry through a gradual anti-inflation strategy, because such a strategy was likely to involve an extended period of high interest rates and weak economic activity. For this reason, the Government had decided to launch a three-pronged attack on inflation which included: 1) a sharp tightening of credit policy and a major improvement in the fiscal posi-

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1/ Price and wage developments are illustrated in Chart 3.

tion, with the deficit declining to a level that could be financed with available foreign savings; 2) a monetary reform, consisting of the adoption of a new currency unit, the austral, and a mechanism to facilitate the de-indexation of financial assets (by limiting windfall gains and losses for creditors and debtors resulting from the sudden decline in interest rates that was expected to be associated with the lower rate of inflation); and 3) a temporary wage-price freeze and the fixing of the exchange rate of the austral in terms of the U.S. dollar.

Following the adoption of the new economic program, the rate of increase in the consumer price index fell from 32 percent in June to 6 percent in July and to a monthly average of 2 1/2 percent in the period August 1985-January 1986; the wholesale price index has risen by about 1/2 percent a month since mid-1985. There have been some shortages of food items at various times since the introduction of the price freeze, but these generally have been addressed by avoiding a rigid enforcement of controls and occasionally by increasing maximum prices. Upward wage pressures gave rise to some adjustments in take-home pay beginning in September 1985; it appears that in general firms that granted pay increases had experienced improved sales and lower unit costs, and that higher labor compensation was not passed on to prices. Indeed, a recovery of industrial production began in August 1985, following a sharp drop of output in June-July associated with a large liquidation of inventories (Chart 5). There are no signs, however, that private fixed investment has begun to recover from its depressed level.

There was full observance of the performance criteria of the stand-by arrangement through the end of July 1985. As of end-September, the net domestic assets of the Central Bank were under the ceiling by a sizable margin, reflecting a substantial overperformance in net international reserves, and the performance criteria related to regulated interest rates and public sector external debt also were met. There were deviations, however, with respect to the other variables subject to limit (Table 5). The limit on Treasury outlays was exceeded by a small amount, while the limit on the combined fiscal deficit was exceeded by a sizable margin, reflecting an excess of the deficit of the nonfinancial public sector. Also, the planned reduction in external payments arrears did not materialize, despite the substantial overperformance in net international reserves. In addition, there was a failure to observe the requirements to increase the proportion of base-year imports in the automatic list to 68 percent by end-September 1985 and to permit private sector interest payments on external financial debt to be made automatically as of end-October 1985.

At the end of December 1985, the target for net international reserves was met and the performance criterion related to regulated interest rates was observed, and available information suggests that the limits on the external debt of the public sector also were met. However, the end-December limit on external payments arrears was exceeded, as were the fourth quarter indicative limits on the nonfinancial public sector deficit and the combined deficit of the public sector in terms of GDP.

III. Principal Policy Issues and the Program for the Remaining Period of the Stand-By Arrangement

1. General policy strategy

The cornerstone of the policy strategy adopted in June 1985 was a major improvement of the public finances that was to obviate the need for any domestic financing of the public sector; together with strict limits on Central Bank credit to the private sector, this policy was expected to result in very low inflation. In that context, the wage-price freeze--which in the initial stages of the program was expected to facilitate the abatement of inflationary expectations--did not seem to involve significant risks of increasing price distortions. Likewise, the fixing of the exchange rate of the austral in terms of the U.S. dollar, following the real depreciation that had taken place in the course of the previous nine months, did not seem to endanger Argentina's competitive position.

In the event, the stance of fiscal policy--while representing a major improvement over that of the first half of 1985--was not fully in accord with the original strategy. As is detailed in subsection 3 below, the combined deficit of the public sector in the second half of 1985 is estimated to have exceeded the equivalent of 4 percent of GDP, or well above the financing available from abroad; this posed the danger that price stability would not be achieved or that the private sector would be squeezed. Maintenance of the original policy strategy requires, therefore, a further reduction of the public sector deficit.

In discussions held in the latter part of 1985, the authorities explained that it was too late to affect significantly the fiscal outcome in the final months of the year and the early months of 1986. However, they were working toward a combined public sector deficit for 1986 as a whole of no more than 3 percent of GDP, roughly equivalent to the deficit of the current account of the balance of payments they projected for the year. They believed that the net use of foreign saving could not be reduced below such a level without seriously impairing the prospects of the incipient recovery, and stressed that they would work toward securing the needed external financing. The authorities expected inflation not to exceed 2 percent a month during 1986, and stated that the monetary program for the year would be designed on that basis.

From a growth perspective, the policy strategy of June 1985 was aimed at fostering saving and investment as well as greater efficiency in the use of resources. The duration of the wage-price freeze was to be limited to the minimum period needed to break wage-price indexation, and the intention of the authorities was to move toward a system in which prices were determined in the market. Growth was predicated on a strong expansion of exports, which was expected to result from the substantial real depreciation of the currency over the period September 1984-June 1985 (Chart 6). Part of the effect of that depreciation had been offset by an increase in export taxes in June 1985; however, it was expected that these taxes, as well as a 10 percent tax on imports introduced in June 1985 for fiscal purposes, would be lowered in the near future as other measures would be taken, particularly on the side of expenditure, to strengthen the public finances on a permanent basis. Measures also were to be adopted to increase the openness of the economy, including the liberalization of the trade and exchange system.

In their letter of February 20, 1986, the authorities have indicated that they plan to introduce structural measures in 1986 aimed at promoting economic growth while consolidating the stabilization effort. The authorities have reaffirmed their commitment to tight fiscal and monetary policies, and are planning actions to reduce the size of the public sector, although these actions would not yield immediate results in lowering public sector spending. They also have reaffirmed their intention to reduce foreign trade taxes and to liberalize the import and payments system, as well as to move as soon as possible to a system in which prices are determined in the market.

2. Wage and price policies

A major policy issue is how to exit from the wage-price freeze without endangering the progress made in reducing inflation. In the discussions, the authorities expressed the view that the wage-price freeze had played a key role in their anti-inflation strategy, and said that the freeze could not be eliminated in one stroke; rather, its termination would be the end-result of a gradual process guided by the Government in which the private sector would need to demonstrate its capacity to behave responsibly in the determination of wages and prices. The role of the Government in this process would be particularly important in sectors which had a pace-setting role in the economy or in which the degree of market competition was limited. The need to adopt a cautious approach in lifting the freeze was heightened by strong pressures from the trade unions for wage adjustments and by the persistence of fairly high inflationary expectations in the private sector.

The authorities had hoped that the end of the wage freeze would not be marked by a return to the earlier practice under which the Government set economy-wide wage adjustments. Instead, they had expected that it would be possible to move to a system of sectoral agreements between management and labor providing for upward wage adjustments only to the extent permitted by productivity gains, without an impact on prices. Accordingly, towards the end of 1985 the Government convened the Economic and Social Conference with the participation of the labor unions and entrepreneurial organizations in order to establish guidelines on incomes policy.

In the event, no agreement was reached in the Conference, and the Government decreed a general wage increase of 5 percent for private sector employees as of January 1, 1986, with the proviso that this was to incorporate any wage adjustment granted during the period of the freeze; the authorities noted that firms had indicated that they would absorb this increase without raising prices. At the same time, there was a 50 percent increase in family allowances, representing on average a 2 1/2 percent increase in take-home pay; this increase would not raise the costs of enterprises because it is to be paid out of the surplus of the family allowance funds without any increase in contribution rates. Moreover, private firms were permitted to raise wages by an additional 5 percent in the course of 1986, provided that such an increase could be justified in terms of productivity gains and was not passed on to prices. In explaining this policy, the authorities noted that since the last general wage increase in mid-1985 the consumer price index had risen by 20 percent, but the implied loss in real wages had been offset to a large extent by the sharp reduction in the inflation tax.

In the public sector, there also was a general wage adjustment of 5 percent and a 50 percent increase in family allowances, as well as increases in other allowances, at the beginning of 1986. In the National Administration there were larger increases for various categories of personnel; one half of the employees were granted a pay increase of 30 percent (instead of the general increase of 5 percent) and an additional 11 percent of employees are to be given an increase of a little more than 20 percent. 1/ The total effect of these adjustments is to raise the wage bill of the National Administration by 21 percent.

As regards price controls, Argentine officials felt that the gradual process of decontrol that the Government was contemplating would be more rapid for small firms, particularly in sectors in which there is a substantial degree of competition. For the time being, large firms would continue to be subject to cost- and price-reporting requirements and would have to justify price increases on the basis of cost developments consistent with incomes and other policies set by the Government. The authorities were aware of the need to permit adjustments in relative prices, and the sectoral arrangements they were envisaging with firms would seek to provide for such adjustments without raising the average level of prices in each sector. The authorities emphasized that there had been no signs of shortages of industrial products, and said that their intention was to continue to apply the controls flexibly so as to avoid shortages. In any case, they reaffirmed that it was the intention of the Government to move as soon as possible to a system in which prices would be determined in the market.

1/ For military personnel in active service, one of the groups receiving a 30 percent pay adjustment, the increase incorporated the effect on take-home pay of a special loan granted in the fourth quarter of 1985.

3. Fiscal developments and policy

a. Fiscal developments in the second half of 1985

Preliminary estimates for the second half of 1985 suggest that the combined public sector deficit declined to the equivalent of 4 1/4 percent of GDP from about 12 3/4 percent of GDP in the first half of the year. The decline reflected sharp cutbacks both in the cash deficit of the nonfinancial public sector and in the losses of the Central Bank (Table 6 and Chart 7). The reduction of the cash deficit of the nonfinancial public sector in the second half of 1985 resulted from a combination of factors, the most important of which were the large increases in public sector prices in May-June, new revenue measures (mainly the compulsory savings plan and additional foreign trade taxes), and the effect of lower inflation on the real value of tax collections. The strengthening of the operating position of the Central Bank for the most part stemmed from the decline in interest rates and changes in the structure of the Bank's balance sheet (as explained below).

The deficit of the nonfinancial public sector was equivalent to about 3 percent of GDP in the second half of 1985, some 5 percentage points of GDP less than in the first half of the year but 1-1/2 percentage points of GDP more than had been programmed. It appears that spending was about 2 percent of GDP higher than had been projected at midyear, while revenue exceeded the amount projected by about 1/2 percent of GDP. In the third quarter, revenue was lower than projected because of delays in the passage of legislation establishing the compulsory savings plan, but this shortfall was corrected in the fourth quarter. Estimates of the fiscal performance in recent quarters, compared with the program are presented in the following tabulation.

The authorities explained that the expenditure overrun in the second half of 1985 for the most part reflected errors in the estimates prepared at midyear. The only expenditure-raising measures introduced in the second half of the year were an increase of 14 percent in social security benefits announced in October and an upward adjustment in take-home pay for military personnel in the form of a special loan; the combined effect of these two measures was estimated at less than one percent of GDP on an annual basis. Among the estimation errors, the authorities cited the failure to make sufficient allowances for salary payments to certain categories of employees and for Treasury transfers to the provinces, as well as larger than projected expenditure by the State Oil Company. The mission noted that the possibility of estimation errors had been envisioned when the program was prepared, and for this reason emphasis had been given to the design of contingency measures that could be put into effect quickly if the fiscal accounts developed less favorably than had been projected. In the event, such contingency measures were not implemented, with the result that the pace of spending actually rose in the second half of 1985, whereas the plan had contemplated a reduction.

Summary of Public Sector Operations

(In percent of GDP)

	1985				1986	
	III		IV		I	
	Program	Actual	Program	Actual 1/	Orig. Prog.	Rev. Prog.
Nonfinancial public sector 2/						
Revenue 3/	26.9	26.7	27.7	28.9 4/	25.4	25.4
Spending 5/	27.7	29.2	29.7	32.3	25.8	28.4
Deficit (-)	-0.8	-2.5	-2.0	-3.4	-0.4	-3.0
Operating position of the Central Bank	-1.2	-1.2	-1.0	-1.3	-0.8	-1.0
Combined public sector deficit (-)	-2.0	-3.7	-3.0	-4.7	-1.2	-4.0

In assessing the fiscal performance in the second half of 1985, special attention needs to be given to the operations of the State Oil Company (YPF). Adjustments made in the first half of 1985 in the prices charged by YPF, net of taxes, had been estimated to raise such prices by 50 percent in real terms from the second half of 1984 to the second half of 1985. With the resulting increase in income, YPF was expected to be able to maintain the scale of its operations without increasing short-term debt, while meeting in full the interest payments on its foreign debt and bringing up to date the transfers to the Treasury of the proceeds from the fuel tax. As it turned out, YPF made only small payments against its foreign interest obligations, failed to reduce the backlog of fuel taxes owed to the Treasury in June 1985, and apparently continued to build up debts with suppliers and contractors. While a complete picture of the operations of YPF in the second half of 1985 is not available, it would seem that the inability of YPF to make those payments was associated with increases in other expenditures. In short, YPF has been running a deficit officially estimated at about ₳ 700

1/ Preliminary.
2/ Cash basis.
3/ Excludes the current revenue of the public enterprises.
4/ Adjusted to exclude ₳ 170 million representing estimated transfers from the Family Allowance Funds to the Social Security System out of surpluses accumulated by the Funds in earlier periods.
5/ Includes current account deficits and capital expenditure of the public enterprises.

million a year (well above 1 percent of GDP), whereas the plan had provided that YPF be in approximate balance. 1/

The higher than expected fiscal deficit in the second half of 1985 was manifested in the emergence of a serious problem in the government-owned National Mortgage Bank. The fiscal plan for the latter part of 1985 had made provision for the transfer to the Social Security System of one fourth of the gross income of the Family Allowance Funds, to cover the projected deficit of the system. These Funds (which for all practical purposes are public bodies financed through a contribution of 12 percent of wages paid by most private employers, but have not been included in the definition of the nonfinancial public sector) in mid-1985 were running surpluses of the order of 1 percent of GDP, which were placed with the National Mortgage Bank and used for the financing of housing construction. In the event, legislation was passed in late September 1985 that provided not only for the transfer to the Social Security System of 3 percentage points of the employers' contribution to the Family Allowance Funds, but also of about ₳ 275 million of the Funds' deposits with the National Mortgage Bank (representing past surpluses of the Funds, which already had been invested by the Bank). About ₳ 170 million of these deposits was effectively transferred in the last quarter of 1985, with the result that the Central Bank had to provide relief to the National Mortgage Bank for an equivalent amount.

Data on the losses of the Central Bank for the third quarter of 1985 indicate that they declined to the equivalent of 1.2 percent of GDP, as projected, from more than 4 percent of GDP in the first half of the year. The decline resulted from the marked reduction in nominal interest rates and an improvement in the structure of the Bank's balance sheet, in reflection of a large increase in the Bank's interest-free liabilities (mainly currency in circulation and required reserves against demand deposits) and the discontinuation of the extension of (interest-free) credit to the Treasury out of resources obtained domestically. Estimates for the fourth quarter of 1985 point to a small increase in the Central Bank's losses, owing mainly to a widening of the interest rate spread between the Bank's liabilities and assets that reflected the strong expansion of low-interest rediscounts in the period July-October 1985.

b. Fiscal prospects for 1986

The budget proposal for 1986, recently submitted to the Congress, provides for a deficit of the nonfinancial public sector on a commitment basis of 2.9 percent of GDP. On that premise, the authorities expected the cash deficit of the nonfinancial public sector to be of the order of

1/ To the extent that YPF's deficit was financed by increases in debt to suppliers and contractors, it was not reflected in the estimates of the deficit presented in Table 6 and the previous tabulation, which are on a cash basis.

2 percent of GDP, which, together with Central Bank losses of about 1 percent of GDP, would result in a combined public sector deficit of no more than 3 percent of GDP in 1986. They stressed that reducing the combined deficit to this level would involve a major effort.

Substantial revenue gains are expected from certain components of the tax reform of 1985 that still have to be passed by the Congress (such as modifications in the administration of the value added tax) and other tax measures, including the introduction of a land tax that would offset a significant part of a planned reduction in export taxes. The export taxes for certain agricultural products already have been reduced--in the case of wheat from 26.5 percent to 15 percent--and taxes on other traditional exports are to be reduced in the near future, in the context of an effort to bolster farm production under a program that would be supported by an IBRD loan. Moreover, the estimates assume some increase in real terms in the prices of goods and services marketed by the public enterprises and a large recovery of advances provided by the Treasury to private firms through the honoring of guarantees in earlier years. The revenue estimates also include further transfers from the Family Allowance Funds to the Social Security System. 1/

The budget proposal provides for a 2 1/2 percent increase in real expenditure by the National Administration; excluding external interest payments, which are expected to decline because of lower interest rates, the increase in real expenditure would be 8 percent, with the wage bill rising by 4 percent in real terms. Estimates contained in the budget suggest that real expenditure by the nonfinancial public sector as a whole would decline slightly, as a reduction in the real wage bill of the provinces and a marked improvement in the operating position of the public enterprises would more than offset increased spending in other areas, especially social security and pension benefits and capital formation (Table 7); the improvement in the position of the enterprises reflects the full-year effect in 1986 of the real public sector price increases in mid-1985 and cuts in spending by YPF, as well as changes in the distribution of income from the sale of oil products between YPF and the Treasury which do not have a net effect on the overall public sector deficit. 2/ In terms of GDP, the budget estimates a reduction in nonfinancial public sector expenditure on a commitment basis of 1 1/2 percentage points in 1986, while on a cash basis there could be an increase of about 1/2 percentage point. 3/

1/ Together with the increase in family allowances at the beginning of 1986, these transfers would virtually eliminate the Funds' surpluses. It should be noted that, to the extent that these transfers were to necessitate the drawdown of the Funds' deposits accumulated in the past, it would not be appropriate to treat them as revenue in 1986.

2/ Adjusted for this factor, nonfinancial public sector expenditure (commitment basis) in real terms would go up by 1 1/2 percent in 1986.

3/ These estimates are based on real GDP growth of 4 percent in 1986 and 8 percent over the year ending in the second half of 1986.

The authorities have been developing a plan to deal with the deficit of YPF. Expenditure would be reduced by about ₳ 200 million in 1986, mostly in investment; to safeguard the prospects for an expansion of oil and gas production, there would be greater involvement of the private sector in exploration and production activities, and bids for exploration contracts for certain areas already have been received from private companies. Improvements in the management of YPF, including a rationalization of the investment program, are being discussed with the IBRD. Also, as noted, YPF would be allowed to keep a greater share of the final price of oil products (at the expense of the tax component) to meet external and domestic interest payments of nearly ₳ 500 million.

As regards the losses of the Central Bank, the authorities expect to be able to keep them to no more than 1 percent of GDP in 1986. To this effect, since the beginning of 1986 the Central Bank has raised by 1 percentage point the interest rate on the rediscount line related to the July 1982 refinancing of domestic private sector debt, and further measures are to be taken in coming months.

The staff stressed that keeping the combined fiscal deficit in 1986 to no more than 3 percent of GDP was essential for the internal consistency of the authorities' strategy, since a deficit of that order of magnitude would be on the borderline of what could be seen as compatible with low inflation and the avoidance of significant crowding out of the private sector. In this respect, the elimination of the surplus of the Family Allowance Funds has removed a source of public sector savings which had been providing support for private housing construction. Furthermore, the staff drew attention to the uncertainties surrounding the fiscal estimates, including doubts whether planning on a budget deficit (commitment basis) of nearly 3 percent of GDP would be consistent with a cash deficit of the nonfinancial public sector of 2 percent of GDP. 1/ In any event, it was clear that attainment of the objectives set for the fiscal deficit in 1986 would require an extremely cautious attitude toward supplementary spending measures, an effective tightening of expenditure control (particularly as regards the public

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1/ With inflation, the lag between the recording of commitment and cash expenditure makes for a level of expenditure (and deficit) that is lower on a cash basis than on a budget basis. Because of the sharply lower rate of inflation that is projected for 1986, the official projections provide for a much smaller difference between the budget and cash outcomes than has occurred in recent years; however, the staff is of the view that the official estimates still may overstate the difference between commitments and cash spending. Cash expenditure also could be lower than commitments if there were a build-up in unpaid bills or other types of floating debt of the public sector, or if supplementary budget allocations were to be approved late in the year and be reflected in cash spending only in 1987; however, the difference between the budget and cash outcomes in the official projections is not based on these two factors.

enterprises), and continuing improvements in revenue collection procedures. Beyond that, if the evidence pointed to deviations from the desired fiscal path, the authorities would need to act quickly to bring the fiscal position back on track.

The failure to achieve the goals concerning the reduction of public expenditure that were incorporated in the program of mid-1985 and the outlook for spending in 1986 are to be judged with regard to their implications for efficiency and growth. The authorities stressed that it was their firm intention both to reduce the size of the public sector and to improve the efficiency of public enterprises. They noted that they had been developing plans with these objectives in mind, and the Minister of Economy recently has announced that the Government would offer for sale its interest in certain steel, petrochemical, and mining companies. While this action was not expected to help bring down spending in 1986, it would have beneficial effects over time.

The fiscal measures the authorities are contemplating to keep the combined deficit to no more than 3 percent of GDP in 1986 as a whole are not expected to produce significant effects in the first quarter of the year. As a result, the combined public sector deficit would not change materially from its level in the second half of last year, i.e., it would continue to be of the order of 4 percent of GDP. Accordingly, a limit of ₳ 593 million has been set on the combined public sector deficit for the period January-March 1986, with a sublimit on the cash deficit of the nonfinancial public sector of ₳ 443 million. Moreover, with a view to ensuring a measure of spending restraint, a limit of ₳ 1,812 million has been set for Treasury outlays in this period.

4. Monetary and credit policies

In their letter of July 22, 1985, the authorities had stated that to ensure confidence in the internal and external stability of the austral, the Central Bank's operations in the early stages of the program essentially would be limited to issuing currency against the purchase of foreign exchange, and limits on the net domestic assets of the monetary authorities were established with that basic principle in mind. In the aggregate, credit policy through September 1985 was consistent with that intention, and the program's limit on the Bank's net domestic assets was observed.

The monetary aggregates continued to grow fairly rapidly after June 1985 and, as is shown in Chart 8, following a period in which the aggregates declined sharply in real terms, from June to September 1985 real M-1 and M-5 rose by 52 percent and 39 percent, respectively. 1/

1/ Historical data on the operations of the financial system are presented in Table 8.

However, the increase in the aggregates did not originate in the extension of net domestic credit by the Central Bank but in an improvement of about US$500 million in net official international reserves, compared with a decline in reserves of US$200 million that had been allowed for in the program; the overperformance in respect of the international reserve target was largely due to an apparent refinancing of private sector external arrears in response to relative cost considerations. In general, the authorities were satisfied that the rapid expansion of the monetary aggregates in the third quarter basically reflected increased demand for money and thus did not give rise to inflationary pressures.

Selected Financial Indicators

(In percent)

	Growth of Aggregates 1/		Interfirm	Exchange
	Total M-1	M-5	Interest Rate 2/	Rate Spread 3/
1984 I	19.3	18.7	13.6	42.6
II	16.0	16.9	18.0	51.1
III	17.7	22.1	18.9	37.3
IV	14.9	15.2	27.2	17.9
1985 I	17.8	20.2	24.3	26.5
II	29.5	27.2	32.0	18.0
July	39.0	28.4	7.7	16.8
August	11.1	9.8	8.6	18.0
September	9.8	9.9	6.2	16.4
October	10.7	7.1	5.3	14.5
November	11.5	5.6	5.6	11.9
December	7.9	4.6	6.0	6.2
1986 January	...	...	5.7	12.4

Argentine officials said that the notion that credit policy in the third quarter of 1985 had been appropriately tight found support in the behavior of interest rates. To be sure, nominal interest rates declined sharply following the introduction of the new program--e.g., the monthly interfirm market rate fell from more than 40 percent in the first half

1/ Average seasonally adjusted monthly increase.

2/ Average monthly rate, against security of U.S. dollar-denominated bonds of the Government of Argentina (BONEX).

3/ Percentage difference in the exchange rate in terms of australes per U.S. dollar in the parallel and official exchange markets.

of June to just over 8 percent in July-August--but they exceeded the observed rate of price increase by wide margins. Despite a further reduction to just over 6 percent in September, the interfirm rate still was about 4 percentage points higher than the increase in the consumer price index in that month. Regulated rates were brought down sharply after mid-June 1985, with the rate for 30-day deposits being reduced from 28 percent a month in the first half of June to 3 1/2 percent a month during the third quarter; nevertheless, the latter figure was consistent with observance of the performance criterion applicable to such rates. For a brief period in the second half of June, the spread between the official and parallel exchange rate disappeared, but a spread of more than 15 percent reemerged in late June, and this was followed by little change in the spread through September.

While the thrust of credit policy through September was consistent with the performance criteria set in midyear, there were departures in some important aspects of the program's implementation. The intention of the authorities had been not to increase rediscounts, but in fact there was a rise in rediscounts of about ₳ 1.3 billion from end-June to end-October, largely matched by an increase in the banks' compulsory reserve and investment requirements. Central Bank officials explained that the rise in rediscounts was not the result of policy decisions but reflected the utilization by banks of two pre-existing automatic rediscount lines, namely, one for the prefinancing of exports (the attractiveness of which was enhanced by the fixing of the exchange rate, as the cost of credit to exporters basically is limited under this rediscount scheme to the rate of depreciation) and the other to cover declines in deposits indexed to prices or the exchange rate (these deposits fell sharply as a result of the reduction of inflation and the maintenance of a fixed exchange rate).

In November, the Central Bank took measures to reduce the attractiveness of the rediscount lines for export prefinancing and for declines of indexed deposits. The growth of rediscounts slowed, but remained fairly large, partly reflecting the extension of credit to official banks which had incurred reserve deficiencies. Interest rates rose substantially in the course of November and into early December, when the interfirm rate exceeded 7 percent. As a result, the spread between the exchange rates in the official and parallel exchange markets came down to 6 percent in December. However, interest rates began to decline again starting in mid-December, and in January 1986 the average spread between the two exchange rates exceeded 12 percent. On a seasonally adjusted basis, the growth of M1 came down to 8 percent in December 1985 from a monthly average of 11 percent in the period August-November, while the growth of M5 declined fairly steadily from nearly 10 percent a month in August-September to less than 5 percent in December.

As regards the stance of monetary and credit policy for the period ahead, there was a question about the likely effect of the past or prospective reduction in the rate of inflation on the demand for real cash balances. Because of the uncertainty about the evolution of money demand and given the importance of consolidating the progress made in curbing inflation, it was agreed that central bank credit policy would need to be very cautious. Accordingly, a limit of ₳ 1,042 million for the first quarter of 1986 was set on the Central Bank's net domestic assets, measured as the Bank's monetary liabilities minus international reserves. This limit allows for a small increase in the velocity of broad money (after taking account of seasonal factors) and the change in net international reserves that is programmed for the quarter.

Argentine officials expressed concern about the persistence of high levels of interest rates relative to the observed rate of inflation, although it was observed that real interest rates measured in terms of expected inflation might not be that high. In any case, it was recognized that it would not be appropriate to seek a reduction of interest rates through the pursuit of more expansionary credit policy, as this would be likely to raise inflationary expectations and would be self-defeating. The authorities noted that a lasting reduction of interest rates would require a consolidation of the public finances, an improvement in the efficiency of financial intermediation, and the continuing abatement of inflationary expectations. As regards the regulated segment of the financial system, in setting interest rates the Central Bank will continue to be guided by the principle established in the first review of the program, which ensures that rates are at least about equal to the rate of inflation. The Central Bank is to permit the nonregulated segment of the market to expand, so that interest rates in this segment reflect market forces.

It would seem that the level of interest rates in the free segment of the financial system has been affected by the high reserve and investment requirements on private banks necessitated by the large volume of rediscounts and by the reserve deficiencies of official banks. The authorities have indicated that, to make possible a lowering of reserve requirements without undermining the overall policy of monetary restraint, the Central Bank will tighten enforcement of reserve requirements and will follow a restrictive policy in the granting of new rediscounts, at the same time that repayment of earlier rediscounts will be encouraged, inter alia, by narrowing the gap between the cost of rediscounts and market interest rates. Such a policy would contribute to a strengthening of the financial system by permitting a reduction in the spread between lending and deposit rates, thereby enabling banks to compete better with parallel financial intermediaries. The authorities indicated that they were planning a major reform of the financial system to reduce operating costs (now estimated on average at more than 1 1/2 percent a month of the banks' deposit liabilities).

5. External policies and outlook

a. The balance of payments and the exchange rate

The overall balance of payments deficit in 1985 is estimated to have been less than US$700 million, or US$1 billion smaller than programmed in June (Table 9 and following tabulation). The current account deficit declined by US$1.1 billion to about US$1.3 billion, or some US$500 million less than had been projected; net factor payments were below the June estimate by about US$200 million, while there was a shortfall in merchandise imports of US$600 million, only half of which was offset by lower than expected exports. Net capital inflows changed little relative to 1985 but were some US$500 million higher than had been projected, reflecting the refinancing of private sector arrears.

Summary Balance of Payments

(In millions of U.S. dollars)

	1984	1985		1986
	Actual	Program	Actual	Official Projection
Current account	-2,391	-1,741	-1,260	-2,337
Merchandise exports	8,107	8,708	8,398	7,793
Merchandise imports	-4,584	-4,650	-4,050	-4,650
Factor services, net	-5,712	-5,537	-5,331	-5,157
Other	-202	-262	-277	-323
Capital account	647	91	597	-1,099
Overall balance	-1,744	-1,650	-663	-3,436

Official balance of payments projections point to a widening of the current account deficit to US$2.3 billion in 1986. This would reflect a US$0.6 billion reduction in exports--resulting from recent declines in commodity prices and the estimated effects on crops of extensive flooding in November 1985--and a US$0.6 billion (15 percent) increase in imports, partly offset by a US$200 million decline in net factor payments. Moreover, the capital account would shift from a net inflow of US$0.6 billion in 1985 to a net outflow of US$1.1 billion in 1986; for the most part, this shift could be attributed to larger amortization payments on government bonded debt (about US$600 million of which is believed to be placed with commercial banks), but other capital items also would give rise to smaller net inflows than in 1985. The result would be an overall balance of payments deficit of US$3.4 billion in 1986, US$2.7 billion larger than in 1985. Without significant changes in gross reserves and allowing for certain scheduled movements in reserve liabilities, there would remain an unfinanced balance of payments gap of US$3.3 billion in 1986, which the authorities expect to fill with additional borrowing from commercial banks and international financial institutions, including the Fund.

In the view of the mission, it did not seem reasonable to plan for a deterioration of the overall balance of payments as large as was implied in the official projections. For example, the projections provided for only a modest increase in nonagricultural exports; also, it seemed that the rapid increase projected for imports only could be explained in the context of nondebt-creating capital inflows stronger than those included in the official projections (i.e., the spending decisions behind those additional imports would entail, at least in part, larger direct investment capital inflows or the repatriation of Argentine assets abroad). Moreover, with appropriate financial policies, it was doubtful that--except for the amortization of government bonds--other net capital inflows would be smaller than in 1985. Nevertheless, it was recognized that there was a great deal of uncertainty as regards several components of the balance of payments, and that a balance of payments plan for 1986 as a whole would be better developed during the discussion of the stand-by arrangement that is expected to follow the current one.

For the first quarter of 1986, the program provides for an overall balance of payments deficit of no more than US$878 million. On the assumption that a sizable part of the effects of the November 1985 floods would be felt in the volume of exports in the first quarter of 1986, the current account would be somewhat weaker than in the corresponding quarter of 1985. On the other hand, the capital account would be stronger, as monetary policy would be more attuned to stabilization objectives than in the first quarter of last year.

On the question of the exchange rate that was appropriate in present circumstances, the authorities noted that the inflation that had occurred after June 1985 had not eroded the competitive position of Argentina because of the depreciation of the U.S. dollar (and the austral) against other major currencies. The real exchange value of the austral in terms of a basket of currencies in December 1985 was only a little above its level in July 1985, following the devaluation and the fixing of the exchange rate in June. The December level implied a real effective depreciation of about 3 percent relative to the average of 1983 and of 37 percent relative to September 1984 (in terms of australes per unit of foreign exchange).

The fairly low spread between the parallel and the official exchange rate since the fixing of the latter in terms of the U.S. dollar, and indeed the narrowing of the spread in late 1985, confirmed the authorities in the view that the exchange rate remained appropriate. They were concerned, however, about the evolution of international commodity prices, and were in the process of reducing export taxes to ensure adequate returns to exporters. The mission concurred on the desirability of reducing export taxes, but stressed that such a reduction should be made effective without slippages in the fiscal position. More generally, the mission emphasized that the continuing adequacy of the present relationship between the austral and the U.S. dollar would require the pursuit of financial policies consistent with very low inflation. In any event, it was agreed that the exchange rate would be adjusted as needed to achieve the objectives of the program.

b. Exchange and trade policies 1/

At the time of the conclusion of the last Article IV consultation by the Executive Board, Argentina had certain exchange and trade restrictions and multiple currency practices. There were exchange restrictions in the form of the suspension of foreign exchange sales for certain current transactions, the requirement that the Central Bank had to authorize all other current transactions, the existence of minimum financing terms for most imports, and substantial payments arrears on current international transactions. Multiple currency practices arose from a system of rebates for exports and the allowing of certain current transfers only through the purchase of marketable bonds of the Government of Argentina denominated in U.S. dollars (BONEX), which are traded at a considerable discount. Trade restrictions employed for balance of payments purposes included the ban on imports of "nonessential" consumer goods and industrial inputs produced locally and the requirement of prior authorization for imports of most capital goods and certain industrial inputs.

The program supported by the stand-by arrangement approved by the Executive Board on December 28, 1984 included measures to simplify the exchange and trade system and to eliminate most exchange restrictions beginning in the first quarter of 1985. However, as the program moved off track in early 1985 and delays developed in the debt rescheduling process and in the disbursement of foreign credits, there were slippages in the liberalization of the exchange and trade system. The first review of the stand-by arrangement established a new timetable for the liberalization of the system, consistent with available foreign financing and the balance of payments objectives of the program. In the meantime, the Executive Board granted approval of Argentina's multiple currency practices and exchange restrictions (except for the minimum foreign financing terms for imports other than capital goods, which has discriminatory features) through end-October 1985.

According to the schedule included in the first review of the program, external payments arrears were not to exceed US$1.8 billion by end-September 1985, down from US$3.4 billion at end-June 1985, and were to be eliminated by end-March 1986; also, if the balance of payments performed better than programmed, the elimination of arrears was to be accelerated. In the event, end-September arrears exceeded US$2.4 billion, notwithstanding the substantial overperformance with respect to the overall balance of payments and a downward adjustment of US$150 million in the stock of arrears on the base date (Table 10). The authorities said that administrative delays had made it difficult to settle certain arrears by end-September (including more than US$300 million owed to foreign branches of Argentine banks, which were largely covered by Central Bank foreign exchange deposits with those banks), and that steps were being taken to clear such arrears. It is estimated that

1/ A summary description of Argentina's exchange practices is provided in Appendix III.

by the end of December 1985 external payments arrears had been reduced to US$1,640 million, but they were above the program limit of US$1.1 billion.

Allowing for the overall balance of payments target for the first quarter of 1986 and taking into account that purchases from the Fund and disbursements from commercial banks in this period will be lower than originally expected, it will not be possible to eliminate external arrears by end-March 1986. However, the use of some US$900 million of the Central Bank's gross disposable reserves (which would still leave reserves at a comfortable level) will permit a reduction of arrears to US$1,050 million by the end of March 1986; 1/ these arrears--including some US$500 million which are expected to be refinanced or are covered by Central Bank's foreign exchange deposits--would be cleared by end-June 1986.

To facilitate private sector financial operations, most private sector interest arrears were to have been eliminated by October 31, 1985, and foreign exchange was to have been made available automatically for private sector interest payments on financial debt after that date. In mid-January 1986, the Central Bank took the steps needed to make such payments automatic.

On May 17, 1985, following significant withdrawals from domestic banks of deposits denominated in U.S. dollars and acting out of prudential concern, the Central Bank froze outstanding dollar deposits in the banking system for 120 days, except for the option given depositors to convert maturing deposits into BONEX. Prior to this action, dollar deposits could have been used to effect current payments that otherwise were restricted, and the freeze constituted an intensification of existing restrictions. On August 1, 1985, the Central Bank started to unfreeze these deposits, and by the end of October all deposits had been unfrozen. Also beginning in August, a new system of U.S. dollar deposits in domestic banks was established, under which all dollar deposits are accepted by banks on behalf of the Central Bank.

The program provides that the Central Bank will continue to make foreign exchange available for all licensed private sector imports. In addition, the authorities remain committed to the elimination of all restrictions on payments and transfers related to nonfinancial services (other than tourism), profits, and dividends, although in their letter

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1/ These exclude arrears (mainly on principal) associated with certain refinancing operations noted in Table 4 of the February 20, 1986 letter from the Argentine authorities, which are expected to amount to about US$1.0 billion at the end of March 1986. Developments as regards these other arrears will continue to be monitored by the staff. Data on the Central Bank's net international reserves are presented in Table 11, and the balance of payments financing plan through the first quarter of 1986 is provided in Table 12.

of February 20, 1986 they request that the date by which these restrictions must be eliminated be changed from March 15, 1986 (as set in the first review of the program) to May 15, 1986. Inter alia, this understanding applies to the transfer of income derived from the sale of travel services, mainly airline tickets, for which the provision of foreign exchange at the official rate was suspended on November 15, 1984.

The first review of the program provided that all imports, except a limited list of luxury goods, would be entitled to automatic licensing by March 1986. As transitional steps, 63 percent of the total value of imports in the base period July 1, 1981 to June 30, 1982 were to be on the automatic list by end-July 1985 and 68 percent by end-September 1985. The ratio of automatic imports was raised to 63 percent by end-July, but no further broadening of the automatic list occurred until January 1986, when all electronic goods (including computers) were added to the list; this action raised the percentage of base period imports in the automatic list to 73 percent. At the same time, import duties for these products were increased sharply; the maximum duty rate was increased from 38 percent to 90 percent and many products previously with rates of 10 percent (including some items that already were on the automatic list) were placed at the maximum rate category. The authorities said that this measure was part of an effort to develop a computer industry in Argentina, and stressed that the new duty rates would be reduced in steps to a maximum of 50 percent by October 1990. Official estimates indicate that the average duty rate on electronic products will be around 34 percent by that time, compared with 18 percent prior to the recent modification.

In their letter of February 20, 1986, the authorities noted that the work of the special commission that is studying the tariff schedule with a view to making necessary corrections had experienced delays, and that it would not be feasible to implement the liberalization of the import regime by the end of March 1986. However, they reaffirmed their intention to transfer all goods--except for a limited list of luxury goods--to the automatic list as soon as possible, and they said that this step would occur not later than May 15, 1986. They also said that duty rates might be increased for some of the products which would be transferred to the automatic list, but it was the Government's intention to limit such increases so as not to frustrate the goal of import liberalization that was being sought and not to raise duties on imports already in the automatic list except to correct anomalies in the tariff schedule.

Taxes on foreign trade were increased in June 1985 out of fiscal considerations. An emergency tax of 10 percent on imports was established, initially for a period of six months, and recently this measure was extended to the end of March 1986. The authorities indicated that a further extension may be needed on fiscal grounds, but this extension would not go beyond end-1986. Export taxes were raised in conjunction with the devaluation of mid-June 1985; taxes on the main agricultural exports, which averaged 19 percent in September 1984 and were about 18 percent in May 1985, were raised to an average of 26 percent. At the same time, rebates on nontraditional exports were eliminated and gave way to some degree of taxation on most such exports. As noted above, export taxes recently have been lowered for some agricultural products and are to be lowered for other products. Taxes on nontraditional exports were reduced substantially--and in some cases eliminated--in August 1985, and for a few of these products export rebates of up to 10 percent were reintroduced later in the year.

c. External debt management

At the end of 1983, Argentina's external debt was US$46 billion, equivalent to three fourths of GDP. The ratio of debt service obligations (including all interest due and amortization of loans with an original maturity of more than one year) to exports of goods and nonfactor services was 125 percent in 1983; interest obligations, at US$5.4 billion, were equivalent to 9 percent of GDP or well above one half of exports of goods and nonfactor services (Table 13). Some US$22.2 billion, or 40 percent of the debt outstanding, was either in arrears at the end of 1983 or falling due in 1984.

In 1984, the Argentine authorities entered into negotiations with foreign private and official creditors to restructure external obligations and to obtain new financing. In January 1985, the Paris Club agreed to the rescheduling of an estimated US$2.1 billion of medium- and long-term debt service obligations (both interest and principal), of which US$1.3 billion represented arrears at the end of 1984 and US$0.8 billion obligations falling due in 1985. Bilateral agreements have been finalized with several official creditors and the authorities indicated that, with the possible exception of one country, the remaining agreements were expectedto be concluded in the near future. 1/ On the basis of the reconciliation of obligations eligible for rescheduling made in the context of the bilateral agreements, it is now estimated that the total of rescheduled obligations will be about US$1.6 billion.

Also, several agreements were signed on August 27, 1985 with foreign creditor banks, providing for: (i) the rescheduling of about US$14.2 billion of principal payments that matured between April 1982 and end-1985; (ii) a new medium-term loan of US$4.2 billion to be disbursed during the period of the current stand-by arrangement; (iii) a trade credit maintenance facility that would keep such financing to Argentina at its September 30, 1984 level; and (iv) a stand-by money market facility under which creditor banks agreed to maintain their deposits in foreign branches and agencies of Argentine banks at the level of September 30, 1984. The Government also rescheduled

1/ The bilateral agreement with the Netherlands has been delayed by a dispute concerning payments in arrears by COGASCO, a Dutch-owned natural gas pipeline company incorporated in Argentina.

approximately US$0.6 billion of principal payments to nonbank creditors not covered by the Paris Club. These obligations, which included private sector debt with and without exchange guarantee, were rescheduled by the issuance of promissory notes of the Government and the Central Bank with terms similar to those of the debt rescheduled with banks.

Total external debt (including obligations to the Fund) increased by US$1.8 billion in 1984 and by an estimated US$1.3 billion in 1985. Maturities coming due in 1986 and 1987, including obligations that were originally short term, are estimated at US$9.3 billion and US$6.2 billion, respectively (Table 14). Argentina has agreed with foreign bank creditors on a 90 day rollover of maturities coming due to banks in the first quarter of 1986 and the authorities are expected to seek a medium-term rescheduling of principal due to banks in 1986. The Government also has approached the Paris Club for the rescheduling of service payments on medium- and long-term debt coming due in 1986. The authorities' external debt policy will continue to be guided by the original program limits on the total amount of disbursed external debt of the public sector and on the cumulative net disbursements of short-term debt to public sector entities.

d. Medium-term balance of payments outlook

The staff has projected Argentina's external accounts through 1990 on the assumption that policies will be geared to limiting debt financing (Table 15). It was assumed that policies (including exchange rate policy) would give emphasis to the promotion of exports, so that the volume of exports would rise by 6 percent a year in the period 1988-90 following a rebound in 1987 from the depressed level of 1986. Real GDP would grow by 4 percent a year through 1990, and the volume of imports would rise by 5 percent a year in 1987-90, after a recovery of 13 percent in 1986 that would broadly offset the decline in 1985. With the terms of trade expected to improve slightly after a 10 percent deterioration in 1986, 1/ the merchandise trade surplus would widen from US$3.1 billion in 1986 and US$4.1 billion in 1987 to US$6 billion in 1990. Net factor payments would decline somewhat in 1986 and would then rise slowly. 2/ In all, after widening in 1986 owing to temporary factors, the current account deficit would return in 1987 to the 1985 level in relation to GDP and would continue to narrow in following years, with a small surplus developing by 1990.

It also was assumed that policies would be adequate to induce direct investment and repatriation of Argentine assets abroad, taken

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1/ It is assumed that world inflation would be 4 percent in U.S. dollar terms through 1990, while real GDP growth in industrial countries would be 3 percent.

2/ The six-month LIBOR would be 8.3 percent in 1986 and 8 percent thereafter.

together, of US$0.6 billion in 1986, US$0.8 billion in 1987, US$0.9 billion in 1988, and US$1.2 billion a year in 1989 and 1990. The aim would be to keep gross disposable international reserves ata four months of imports. Under these assumptions, the total external debt would increase until 1988 and decline moderately thereafter. Relative to GDP, total external debt would fall from about 75 percent in 1985 to about 50 percent in 1990. The debt service ratio would remain very high throughout the projection period (although it would decline from 111 percent in 1986 to 67 percent in 1990) and there would likely be a continuing need for debt restructurings.

Given the size of Argentina's external debt, a key assumption in these projections is the level of international interest rates. If these rates turned out to be 1 percentage point higher throughout the projection period, by 1990 interest payments would be higher by close to US$700 million, the current account would still be in deficit by the equivalent of 1/2 percent of GDP, and the debt service ratio would be higher than in the base case by some 5 percentage points. In order to maintain a debt service ratio in 1990 comparable to that of the base scenario, imports would have to remain unchanged in volume terms at the 1985 level; alternatively, exports would have to grow by some 1.5 percentage points more a year in the period 1986-90, or nondebt-creating capital inflows would have to be US$850 million a year higher.

The medium-term scenario presented above incorporates significant exceptional capital inflows in the next few years, in the form of both reschedulings and concerted external borrowing. On the assumption that Argentina will reschedule its external obligations on terms comparable to those reached in 1985 for private and official creditors and that lending by international development banks will be stepped up, the financing gaps that would still remain for the period through 1988 can be judged manageable in terms of their implications for changes in exposure of commercial banks in Argentina. In discussing the medium-term prospects, the authorities stressed the uncertainties of the international setting, especially as regards Argentina's terms of trade and international interest rates. While they were confident that their policies would encourage capital inflows, they wanted to rely also on the use of concerted external borrowing as needed to sustain economic recovery.

6. Performance criteria

For the purchase scheduled for May 1986, the program contains the following performance criteria, all of which are referred to in paragraph 4 of the revised stand-by arrangement as modified and supplemented by the letter of February 20, 1986 from the Minister of Economy and the President of the Central Bank of Argentina. (The quantitative performance criteria for the remainder of the period of the stand-by arrangement are summarized in Table 16).

a. For the first quarter of 1986, limits on the combined deficit of the nonfinancial public sector and the Central Bank; on the cash deficit of the nonfinancial public sector; and on treasury outlays (paragraph 9 and Table 1 of the February 20, 1986 letter).

b. For the first quarter of 1986, a limit on the increase in the net domestic assets of the Central Bank (paragraph 12 and Table 2 of the February 20, 1986 letter).

c. For the period February-April 1986, understandings on regulated interest rates (paragraph 27 of the letter of June 11, 1985).

d. For the first quarter of 1986, a target for the change in the net international reserves of the monetary authorities (paragraph 15 and Table 3 of the letter of February 20, 1986).

e. By May 15, 1986, all imports (except for a limited list of luxury goods) subject to automatic licensing (paragraph 19 of the letter of February 20, 1986).

f. For end-March 1986, the scheduled reduction of external payments arrears (paragraph 17 and Table 4 of the letter of February 20, 1986).

g. For end-March 1986, limits on the total external debt of the public sector and on the cumulative net disbursements of short-term external debt to public sector entities (paragraph 34 and Table 6 of the June 11, 1985 letter).

h. In line with the general intentions expressed in paragraph 35 of the June 11, 1985 letter to make foreign exchange available for bona fide payments and transfers for current international transactions, the intention to make foreign exchange automatically available for all payments and transfers related to services other than tourism by May 15, 1986.

i. Until foreign exchange for the transfer of profits, dividends, and royalties is made available automatically, to continue to permit the cancellation of obligations in respect of profits, dividends, and royalties through the delivery of BONEX (paragraph 35 of the June 11, 1985 letter).

j. The standard provision regarding the exchange and trade system--except that the existing export rebate system, which constitutes a multiple currency practice, can be modified by a reclassification of export items eligible for rebate within the existing range of rates provided that such reclassification does not increase the weighted average export rebate rate (paragraph 30 of the Memorandum of Understanding on Economic Policy attached to the letter of September 25, 1984).

IV. Staff Appraisal

After many years of high inflation and weak growth, in mid-1985 the Government of Argentina adopted a bold program to deal with the problem of inflation and to create the basis for sustained growth of output, employment, and incomes. The cornerstone of the program was a major tightening of financial policies, including a commitment to reduce the public sector deficit to a level that could be financed with a moderate volume of foreign savings. In its initial stage, the program included a wage-price freeze as a means of achieving a quick abatement of expected inflation and thus limiting the effects of the tightening of financial policies on economic activity. The program has brought the rates of increase in the price indices down sharply and, following an initial period of weakness, economic activity has begun to recover. The task facing the authorities at present is to consolidate the stabilization effort at the same time that the distortions and rigidities that have developed in the economy over the years are substantially reduced.

The staff believes that it is essential not to allow slippages in demand policies, which would risk reversing the progress made up to now in reducing inflation and strengthening the country's external position, and thus puts the utmost emphasis on the need to ensure that the fiscal position be consistent with the program's basic strategy. The combined public sector deficit declined markedly after mid-1985, but it remained well above the amount that had been programmed, and domestic financing was required in the second half of the year; the fiscal plan for the first quarter of 1986 indicates that this situation persists. To be sure, it may be possible to keep inflation under control by squeezing the private sector, but this would be at the expense of private investment and the economy's growth potential, and in all likelihood could not be sustained beyond the short term. The authorities' objective of bringing the combined public sector deficit in 1986 to no more than 3 percent of GDP must be seen as a minimum requirement, and the staff's support for Argentina's program is based on the adoption without delay of measures that assure achievement of this objective.

The fiscal effort since the middle of 1985 has focused exclusively on revenue measures, and the staff regrets that the planned reduction of expenditure has not materialized. The staff would thus strongly recommend that the authorities accelerate the adoption of measures to reduce the size of the public sector. An expenditure-reducing policy would facilitate keeping the deficit at low levels after the emergency revenue measures adopted for 1985-86 have lapsed and would be consistent with the provision of more room for the private sector. Such a policy ought to be based on renewed efforts to cut current outlays and to rationalize the operations of public enterprises and decentralized agencies, limiting their investments to those that have a clear priority. In some cases, reductions in public sector investment could be accompanied by a transfer of activities to the private sector, as has been announced recently by the authorities with respect to the steel and petrochemical industries. In any effort to slim down the public sector, the staff would urge the authorities to pay special attention to the operations of the State Oil Company.

Monetary policy inevitably will have to carry a heavy burden in the stabilization effort. The staff notes that the credit program developed for the first quarter of the year is based on a further deceleration in the monetary aggregates and allows for a small decrease in the velocity of money. The staff shares the authorities' view that the current level of interest rates reflects both pressures from the fiscal side and an expected inflation that has remained above the rate of increase in the price indices. It is clear that attempts to lower interest rates by shifting to expansionary credit policies would be counter-productive; the only lasting way to reduce interest rates is by strengthening the fiscal position and working to achieve a reduction of expected inflation through overall demand restraint. In the meantime, to ensure that interest rates reflect market forces more closely, the Central Bank is to allow an enlargement of the nonregulated segment of the financial system and is to avoid that regulated interest rates fall below the rate of inflation.

In the early part of the program, the Central Bank adhered to the planned credit expansion even though there was a rapid growth of rediscounts and rising reserve deficiencies of official banks, as these were offset by increases in reserve requirements. For the first quarter of 1986, the provision of rediscounts is to be tightened and compliance with reserve requirements enforced more vigorously, with a view to making it possible to reduce reserve requirements for all banks within the constraints imposed by the overall credit limits. The staff attaches a great deal of importance to the implementation of policies that would permit a lowering of reserve requirements, as this would strengthen the financial system and would constitute an important step toward the objectives of financial reform.

Pursuit of fiscal and monetary policies along the lines just indicated should permit an early lifting of the wage-price freeze without a resurgence of inflation. In the past few months, the authorities sought agreements with trade unions and entrepreneurial organizations on wage-price behavior. The failure of those efforts led the Government to decree a general wage adjustment that appears to be consistent with achievement of relatively low inflation, provided that further adjustments are limited in size and frequency. Continuation of moderate wage behavior requires that financial policies be geared to ensuring a good price performance, lest pressures for additional wage adjustments develop that may prove difficult to withstand. The large special pay increases granted recently to a high proportion of employees of the National Administration are a cause for concern, not only because of their implications for the public finances but also because of the influence they have on wage behavior throughout the economy.

As regards prices, the evidence suggests that the freeze thus far has not caused serious problems, but the staff is concerned that it will give rise to increasing distortions as time goes on. The authorities intend to apply the controls in such a way as to allow relative price corrections within each sector, but, aside from the practical difficulties of implementation, this policy does not address the likely need for intersectoral relative price adjustments. Moreover, the consolidation of expectations of price stability requires that the price indices show little or no movement in the absence of the freeze. For these reasons, the staff is of the view that price controls should be removed soon, and that the task of maintaining a stable price level should center on demand policies, supplemented whenever necessary by government efforts to ensure competitive markets.

Following a substantial improvement of the current account of the balance of payments in 1985, the official estimates envisage a widening of the deficit in 1986, largely reflecting a decline in exports owing to lower international commodity prices and to the effects of flooding on crop production. A substantial expansion in imports also is expected, which in the staff's view should be related to a recovery of private investment and associated capital inflows. The official balance of payments projection for 1986 implies a sizable unfinanced gap--even after the refinancing of principal to foreign bank creditors and the rescheduling of principal and interest due to official creditors--and in the coming weeks the authorities will seek to determine the feasibility of the proposed financing plan. In the meantime, a target for the overall balance of payments has been set for the first quarter of 1986 that is compatible with available financing and a sizable reduction in external payments arrears in that period.

Although inflation in Argentina since mid-1985 has been higher than in industrial countries, the effective value of the austral in real terms has not risen by much as the austral has depreciated along with the U.S. dollar against other major currencies. Nevertheless, the adequacy of the exchange rate must be kept under close scrutiny, and the spread between the exchange rates in the official and parallel exchange markets should continue to be one of the indicators used to judge the adequacy of policies. In assessing the exchange rate, it should be noted that export taxes on some of the main agricultural products remain high in comparison with the levels of recent years; further reductions in export taxes may be used to assure adequate returns to producers, although it has to be recognized that such reductions affect the public finances and need to be compensated by other fiscal measures. The authorities' indication that the exchange rate will be adjusted if necessary to achieve the balance of payments objectives of the program is welcome.

The plan to eliminate all external payments arrears by end-March 1986 now appears to be out of reach, partly because of the postponement of disbursements of bank loans that are tied to purchases from the Fund. However, the staff notes that in the first quarter of 1986

Argentina is to reduce arrears by some US$600 million by drawing down the Central Bank's gross reserves, and the authorities have indicated that remaining arrears are to be eliminated by mid-1986. The staff further notes that by end-March there are to be no arrears of the private sector (except for some obligations that are expected to be rescheduled) and that all payments and transfers related to services other than tourism are to be automatic by May 15, 1986.

The list of goods that can be imported under automatic license was broadened in January 1986 to 73 percent of base-period imports by placing on that list all electronic products. However, this measure was accompanied by steep increases in duty rates, which in part are to be temporary. The staff is concerned about the adverse effects of the increase in duty rates and would note the importance, as a minimum, of adhering strictly to the planned reduction of the tariff schedule for these products. As regards the rest of imports that were to be placed on the automatic list by end-March 1986, the authorities have indicated that for administrative reasons this action may be delayed, but that it nevertheless would be taken not later than May 15, 1986. The authorities' intention is to keep any import duty increases to an amount that would not frustrate the objective of liberalizing the import regime. Also, the authorities intend to phase out in 1986 the emergency 10 percent tax on imports introduced in June 1985, and the staff would emphasize the need for corrective measures in the fiscal area, so that this tax can be eliminated without impairing the fiscal objectives of the program.

In the letter of February 20, 1986, the Argentine authorities have requested an extension of the stand-by arrangement to May 31, 1986 and a waiver for the performance criteria that have not been observed, and have noted a reduction of the amount of the stand-by arrangement by SDR 236.5 million. In support of their request, the letter from the authorities presents the economic program for the remaining period of the stand-by arrangement. It is the view of the staff that the policies proposed by the authorities, including the objectives for the public finances for the whole of 1986, provide a reasonable basis for the achievement of the objectives of the program. Therefore, it is proposed that Argentina's nonobservance of certain performance criteria be waived, and that the second review of the program be concluded on the basis of the proposed decision. The program provides for a substantial liberalization of the exchange system, and on that basis the staff recommends that Argentina's exchange practices subject to Fund approval (other than the discriminatory minimum financial terms for imports), described in Appendix III, be approved.

It is proposed that the next Article IV consultation take place according to the regular 12-month cycle.

V. Proposed Decisions

Accordingly, the following draft decisions are proposed for adoption by the Executive Board:

A. Stand-by Arrangement

1. Argentina has consulted with the Fund in accordance with paragraph 4(d)(iii) of the revised stand-by arrangement for Argentina (EBS/85/177, Attachment I) and paragraph 37 of the letter of June 11, 1985, attached to the revised stand-by arrangement, in order to reach any necessary understandings on additional measures to ensure achievement of the program's objectives.

2. The letter of February 20, 1986 from the Minister of Economy and the President of the Central Bank of Argentina will be attached to the revised stand-by arrangement, and the letters of September 25, 1984, December 26, 1984, June 11, 1985, and July 22, 1985, heretofore attached to the revised stand-by arrangement, shall be read as supplemented and modified by the letter of February 20, 1986.

3. Accordingly, the quantitative limits and dates of the revised stand-by arrangement shall be read as subject to the modifications and additions set out in the paragraphs and tables listed below of the letter of February 20, 1986, for the period from March 31, 1986 through the expiration of the revised stand-by arrangement.

(a) The ceiling on the net domestic assets of the Central Bank, as described in and under paragraph 4(a)(i) of the revised stand-by arrangement, shall be modified and supplemented as described in paragraph 12 and Table 2 of the letter;

(b) The limit on the combined deficit of the nonfinancial public sector and the Central Bank, the sublimit on the cash deficit of the nonfinancial public sector, and the limit on treasury outlays, as described in and under paragraph 4(a)(ii) of the revised stand-by arrangement, shall be modified and supplemented as described in paragraph 9 and Table 1 of the letter;

(c) The target for net international reserves, as described in and under paragraph 4(b)(i) of the revised stand-by arrangement, shall be modified to apply for the period including January, February, and March 1986, as described in paragraph 15 and Table 3 of the letter;

(d) The schedule for the phased elimination of external payments arrears, as described in and under paragraph 4(b)(ii) of the revised stand-by arrangement, shall be supplemented as described in paragraph 17 and Table 4 of the letter;

(e) The understandings on regulated interest rates, as described in and under paragraph 4(c) of the revised stand-by arrangement, shall be modified to apply for the period including February, March, and April, 1986;

(f) The proportion of base period imports subject to automatic licensing, as described in and under paragraph 4(d)(ii) of the revised stand-by arrangement, shall be modified as described in paragraph 19 of the letter, and

(g) Paragraph 4(f) of the revised stand-by arrangement is amended by substituting "May 15, 1986" for "March 15, 1986."

4. Paragraph 1 of the revised stand-by arrangement is amended by substituting "May 31, 1986" for "March 27, 1986" and, in the light of paragraph 22 of the letter of February 20, 1986, by substituting "SDR 1,182.5 million" for "SDR 1,419 million."

5. Paragraph 2(a) of the revised stand-by arrangement is amended to read:

> "(a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 236.5 million until February 20, 1985, the equivalent of SDR 473.0 million until September 20, 1985, the equivalent of SDR 709.5 million until March 10, 1986, and the equivalent of SDR 946.0 million until May 20, 1986."

6. The Fund finds that the review contemplated in paragraph 4(d)(iii) of the revised stand-by arrangement has been concluded, and that Argentina may proceed to make purchases under the revised stand-by arrangement.

B. Exchange System

The Fund welcomes the intention of Argentina to eliminate restrictions on payments and transfers related to profits, dividends, royalties and services other than tourism and restrictions giving rise to external payments arrears, in the context of a comprehensive balance of payments adjustment program supported by a stand-by arrangement from the Fund. It encourages Argentina to further simplify the exchange system and to eliminate all restrictions on payments and transfers for current international transactions. In the meantime, the Fund grants approval for the retention of the practices described in items 1(a)-(b), items 2(a)-(b), and items 2(e)-(f) of Appendix III of EBS/86/39 until May 31, 1986 and the practices described in items 2(c)-(d) of the same Appendix until May 15, 1986.

Fund Relations with Argentina
(As of January 31, 1986)

I. Membership Status

(a) Date of Membership: September 1956
(b) Status - Article VIII

A. Financial Relations

II. General Department (General Resources Account)

(a) Quota: SDR 1,113.0 million

		Millions of SDRs	Percent of Quota
(b)	Total Fund holdings of australes	3,218.1	289.1
(c)	Fund credit	2,105.1	189.1
	Of which: credit tranches (ordinary resources)	691.5	62.1
	enlarged access resources	618.5	55.6
	compensatory financing facility	795.1	71.4
(d)	Reserve tranche position	--	--

(e) Current Operational Budget: Not applicable

(f) Lending to the Fund: Not applicable

III. Stand-By or Extended Arrangements and Special Facilities

	Type of Arrangement	Amount (SDR million)	Duration	Amount Drawn (SDR million)	Status
(a)	Current				
	SBA	1,419.0	Dec. 28, 1984-March 27, 1986	709.5	Operational
(b)	Previous				
	SBA	1,500.0	Jan.24,1983-April 24, 1984	600.5	Canceled, Jan. 23, 1984
	SBA	159.5	Sept. 16, 1977-Sept. 15, 1978	--	Expired
	SBA	260.0	August 6, 1976-August 5, 1977	159.5	Expired

(c) Special Facilities: CFF

Year Approved	Amount (SDR million)
1984	275.0
1983	520.1
1975	220.0

IV. SDR Department

(a) Net cumulative allocation: SDR 318.37 million
(b) Holdings: SDR 32.72 million, or the equivalent of 10.28 percent of net cumulative allocation
(c) Current Designation Plan: not applicable

V. Administered Accounts (amounts)

(a) Trust Fund Loans: Not applicable
(b) SFF Subsidy Account: Not applicable

B. Nonfinancial Relations

VI. Exchange Rate

On July 1, 1983, the peso argentino replaced the Argentine peso at a conversion rate of 1 peso argentino per 10,000 Argentine pesos; the symbol for the currency remained unchanged ($a). The rate of exchange of the new currency vis-a-vis the dollar continued to be adjusted on a daily basis. As of June 14, 1985, the Argentine currency unit was changed, with the austral (symbol: ₳) replacing the peso argentino at a rate of one austral per 1,000 pesos argentinos; the exchange rate for the austral was fixed at ₳0.800 per U.S. dollar (buying) and ₳0.801 per U.S. dollar (selling).

VII. Last Article IV Consultation

The 1984 Article IV consultation discussions were held in February-June 1984 (EBS/84/167) and the consultation was concluded by the Executive Board on September 4, 1984 (EBM/84/132 and EBM/84/133).

Argentina: Statistical Issues

In recent years, the data base in Argentina has been subject to considerable problems, which have hampered the evaluation of economic policies and the monitoring of developments. In some areas, the data base is poorly developed and statistics are based on rough estimates. In other areas, while reporting systems are in place, coverage is sometimes incomplete and the data become available with substantial lags.

In the course of 1983, it became apparent that the external debt statistics--which had been based on original loan schedules rather than actual disbursements and repayments--did not adequately record debt movements during a period of payments disruption, and the existing reporting system was discontinued. A new survey of the stock of debt at the end of 1983 was completed; however, the new system for collecting debt statistics has not become operational on a current basis, although efforts are being made to achieve a comprehensive registration of both public and private debt. At present, estimates of the stock of debt are based on end-1983 data updated using flow data from the balance of payments' accounts, which are believed to be subject to considerable errors and omissions.

Given the problems with the debt reporting system, external payments arrears were initially measured as the stock of applications to make foreign payments that had been received by the Central Bank but not yet approved. Neither public nor private entities were required to deposit the counterpart in local currency, and the Central Bank did not systematically review the backlog of applications to ensure that they represented valid payments arrears. Beginning in July 1985, the private sector was required to constitute local-currency deposits when applying to make foreign exchange payments, and in the course of the third quarter a large proportion of the external arrears of the private sector were refinanced, without a systematic record being kept in the Central Bank. As a result, there is no firm information on the value of arrears claims that were regularized, and should thus be included in the external debt statistics.

The difficulties with the external data affect the measurement of the borrowing requirements of the nonfinancial public sector to the extent that public debt and external payments arrears are involved. The measurement of the borrowing needs of the nonfinancial public sector is also hampered by problems in the data on domestic financing. There are delays in the reporting of public sector deposits with the banking system, while information on financing received by provincial governments, particularly in the form of debt issues or floating debt, is not gathered on a systematic basis. Moreover, information on the debt of the public enterprises in the form of letters of credit, unpaid obligations to suppliers and contractors, or other short-term nonbank credit, lacks comprehensiveness and currentness.

On the revenue and expenditure of the nonfinancial public sector, monthly data are available in a timely fashion for the Central Administration. However, accounting of the operations of other segments of the nonfinancial public sector on a cash basis to permit the monitoring of fiscal developments on a quarterly basis was begun only in 1983, and problems remain, particularly as regards the public enterprises and the provinces. Furthermore, there is a lack of up-to-date information on fiscal operations on a budget execution basis, which are only prepared on an annual basis. As a result, a close monitoring of nonfinancial public sector revenue and spending is not possible, which makes it difficult to analyze fiscal trends and to exercise budgetary control.

There are also difficulties in the measurement of the operating losses of the Central Bank, in part because the accounting system in the Bank was designed to provide an annual audit and not to track the financial situation of the institution on a monthly or quarterly basis. In particular, detailed information on the Central Bank's outstanding rediscounts is not available in a timely fashion.

In the area of monetary statistics, information is available with less than a month's lag on the monthly averages of the monetary aggregates based on data on the required reserves of financial institutions. However, comprehensive information from this source is only available since the end of 1983 and does not distinguish between public and private holdings. As a result, it is difficult to analyze the data--for example, to develop reliable factors for seasonal adjustment--or to use them to cast light on fiscal developments. Data on the monetary aggregates on an end-of-month basis (from the accounts of the financial institutions) has a longer historical reach and distinguishes between public and private deposits, but this information is subject to a delay of three months or more.

There are shortcomings in the Central Bank balance sheet, including delayed recording of external transactions, which the Bank is now in the process of correcting. Purchases of foreign exchange by the Central Bank are reflected in the accounts at the exchange rate of the date of each operation, while sales of foreign exchange are recorded at the average exchange rate of past transactions; consequently, the net stock of foreign exchange is accounted for at an average exchange rate that historically has differed substantially from the end-of-period rate. As regards the accounts of other financial institutions, work continues on data revisions and recompilation, which Central Bank officials expect to be completed by around April 1986.

The statistical base for certain important series on prices and output is outdated. The weights in the consumer price index are based on a family expenditure survey of September 1974; a new survey was conducted in February 1985, and it is expected that the new index will be introduced in 1987. Also, the index of industrial production is based on an establishment survey conducted in 1974, and does not take account of the changes in the structure of the industrial sector that are believed to have occurred since then.

The situation as regards the data published in Fund publications is as follows:

1. Government Finance Statistics Yearbook (GFSY)

The 1985 issue of the GFSY includes data in the statistical and derivation tables through 1983 for the consolidated central government. Data for provincial governments are also included through 1983. As regards the coverage of local governments in the GFSY, the Bureau of Statistics is in correspondence with Argentine officials.

2. International Financial Statistics (IFS)

The data published in IFS are based on reports sent to the Fund's Bureau of Statistics by the Central Bank of Argentina. The currentness and coverage of data published in the country page for Argentina in the February 1986 issue of IFS are shown below.

		Latest Data in February 1986 IFS
Real Sector	-National Accounts	1983
	-Prices: wholesale prices	October 1985
	consumer prices	November 1985
	-Production: manufacturing	Q2 1983
	crude petroleum	August 1985
	-Employment	n.a.
	-Earnings	n.a.
Government Finance	-Deficit/Surplus	June 1985
	-Financing	June 1985
	-Debt	1983
Monetary Accounts	-Monetary Authorities	June 1985 (partial)
	-Deposit Money Banks	June 1985 (partial)
	-Other Financial Institutions	June 1985 (partial)
	-Interest Rates: deposit rate	March 1985
	lending rate	June 1985
External Sector	-Merchandise Trade: value	Q1 1985
	prices	Q1 1985
	-Balance of Payments	Q2 1985
	-International Reserves	October 1985
	-Exchange Rates	December 1985

Argentina: Exchange Practices

The exchange and trade system currently in effect in Argentina involves the following multiple currency practices and restrictions on payments and transfers for current international transactions.

1. Multiple currency practices

a. Argentina maintains a system of rebates for certain exports which is implemented through the exchange system. These rebates are set as a percentage of export value, and the exchange proceeds must be surrendered as a condition for the payment of the rebate. There are rebates of up to 10 percent for a few products, and exports originating in certain less developed regions of the country and shipped through specified ports are eligible for special export rebates of 7 to 12 percent. In addition, rebates of 5 percent have been provided for fixed periods for exports of certain goods to specified new markets.

b. Various service payments, for which foreign exchange is not currently being provided, can be transferred through the acquisition with local currency of marketable Government of Argentine bonds denominated in U.S. dollars (BONEX) and the sale of BONEX for foreign currency in markets abroad, giving rise to multiple currency practices. For certain service payments and transfers, such as the transfer of income derived from the sale of travel services, the acquisition of BONEX is permitted only by means of purchase with local currency in the secondary market in Argentina, whereas for others, such as the transfer of dividends, acquisition by means of a central bank BONEX subscription at the official exchange rate is possible. Acquisition of BONEX in the domestic secondary market for sale abroad is equivalent to transferring money through the parallel exchange market, as the ratio of the local currency price of BONEX in Argentina and the U.S. dollar price abroad follows the exchange rate in the parallel market. The acquisition of BONEX through central bank subscription constitutes a multiple currency practice as well, due to the existence of a discount in the U.S. dollar price of BONEX in the foreign market with respect to the subscription value.

2. Exchange restrictions

a. An exchange restriction arises from the existence of arrears on payments and transfers for current international transactions. External payments arrears amounted to US$1.64 billion at the end of 1985.

b. Sales of exchange at the official rate for travel abroad have been suspended since September 30, 1983.

c. Sales of foreign exchange to effect the transfer of profits, dividends, royalties, and payments for technical assistance have been suspended since May 18, 1984. The cancellation of such obligations is permitted through the delivery of BONEX.

d. Prior central bank approval is required for the sale of exchange to effect all payments and transfers, except payments related to imports and interest payments on most private external debt. At present, such authorization is not automatically granted for all bona fide current payments and transfers.

e. The sale of exchange is not currently permitted for the repayment of foreign loans for which the domestic borrower obtained an exchange rate guarantee during 1981 or 1982; in some instances, these loans were related to trade finance. The foreign creditor must reschedule such loans, either by accepting a U.S. dollar-denominated debt instrument of the Government of Argentina, or by renegotiating the loan directly with the domestic borrower according to minimum terms established by the Central Bank. In July 1985, the Central Bank issued regulations regarding the renegotiations of these loans and the corresponding government debt instruments are to be issued.

f. Minimum foreign financing terms of between one and five years apply to imports of capital goods valued at more than US$50,000.

g. Minimum foreign financing terms have been established for most imports other than capital goods.

Argentina--Basic Data

Area and population	
Area (continental)	2,792,000 sq. kilometers
Population (mid-1984)	30.1 million
Annual rate of population increase (1980-84)	1.6 percent
GDP (1984)	SDR 64.6 billion 1/
	US$66.2 billion 1/
	₳ 5.02 billion
GDP per capita (1984)	SDR 2,145 1/

	1981	1982	1983	1984	Prel. 1985
Origin of GDP			(percent)		
Agriculture, livestock and fishing	13.9	15.6	15.4	15.6	...
Mining	2.7	2.8	2.8	2.7	...
Manufacturing	22.4	22.5	24.2	24.5	...
Construction	6.1	5.1	4.6	3.6	...
Electricity, gas, and water	3.8	4.1	4.3	4.4	...
Commerce	14.9	12.9	12.9	13.2	...
Transport and communications	11.0	11.3	11.4	11.6	...
Finance and banking	9.2	8.6	7.7	7.5	...
Other services	16.1	17.0	16.8	16.7	...
Ratios to GDP					
Exports of goods and non-factor services 1/	20.1	16.5	15.3	15.2	15.6
Imports of goods and non-factor services 1/	21.8	12.4	10.6	10.1	9.4
Factor services (net) 1/	-6.4	-8.2	-8.7	-8.6	-8.2
Current account of the balance of payments 1/	-8.2	-4.1	-4.0	-3.6	-1.9
General government revenues	25.4	23.0	23.5	23.9	28.2
General government expenditures	38.4	36.1	42.0	35.1	33.3
Public sector savings	-6.1	-9.0	-7.6	-4.7	2.9
Public sector overall balance	-16.7	-18.0	-17.9	-13.1	-4.8
External debt (end of year) 1/	62.0	74.7	74.1	72.3	75.7
Gross national savings	13.4	12.5	14.0	11.5	12.9
Gross aggregate investment	18.2	18.0	17.9	15.8	15.0
Financial system liabilities to private sector (end of year)	38.3	32.6	35.3	34.3	31.3
Annual changes in selected economic variables					
Real GDP per capita	-7.9	-6.7	1.7	0.8	-6.0
Real GDP at 1970 prices	-6.5	-5.2	3.4	2.4	-4.5
GDP at current prices	93.2	169.6	362.5	634.9	619.0
Domestic expenditures (at current prices)	89.9	159.8	354.6	646.4	644.2
Consumption	100.0	158.1	353.5	669.3	656.3
Investment	54.8	167.5	359.2	548.1	582.2
GDP deflator	107.0	184.1	347.5	617.6	652.8
Wholesale prices (annual average)	110.0	258.1	360.9	574.0	662.4
Consumer prices (annual average)	104.5	164.8	343.8	626.7	672.0
General government revenues	78.1	144.4	371.5	647.8	750.5
General government expenditures	128.8	152.9	439.3	513.7	582.6
Financial system liabilities to private sector	102.2	109.6	354.6	526.8	429.0
Monetary liabilities	69.7	220.3	368.2	524.7	571.5
Other liabilities	114.2	80.5	349.2	527.5	392.3
Net domestic assets 2/3/	120.6	185.1	405.1	550.1	480.7
Credit to private sector 2/	103.6	138.2	280.3	348.0	309.5
Other 2/3/	17.0	47.0	124.8	202.1	171.2
Merchandise exports (f.o.b. in U.S. dollars)	14.0	-16.6	2.8	3.5	3.6
Merchandise imports (c.i.f. in U.S. dollars)	-10.5	-43.4	-15.6	1.8	-11.6

General government finances 4/	1981	1982	1983	1984	1985
		(millions of australes)			
Revenue	13.9	34.0	160.2	1,197.9	10,187.4
Expenditure	21.0	53.2	287.0	1,761.4	12,023.0
Current account balance	-2.3	-7.6	-34.1	-161.5	1,026.3
Overall balance	-7.1	-19.2	-126.8	-563.5	-1,835.6
External financing (net)	2.2	2.7	1.9	-69.2	54.0
Internal financing (net)	4.9	16.5	124.9	632.7	1,781.6
Balance of payments		(billions of U.S. dollars)			
Merchandise exports, f.o.b	9.1	7.6	7.8	8.1	8.4
Merchandise imports, c.i.f.	9.4	5.3	4.5	4.6	4.1
Travel (net)	-1.1	--	-0.1	-0.1	-0.2
Interest payments	3.9	4.9	5.4	5.5	5.2
Other factor income (net)	0.2	0.2	--	-0.2	-0.2
Other services and transfers (net)	0.3	--	-0.3	-0.1	-0.1
Balance on current account	-4.7	-2.4	-2.5	-2.4	-1.3
Financial loans to nonfinancial public sector	4.1	0.2	-0.5	2.3	...
Other capital flows	-3.0	-4.0	0.5	-1.7	...
SDR allocations and valuation adjustments	-0.3	-0.1	-0.3	-0.1	0.1
Changes in official net reserves (increase -)	3.9	6.3	2.8	1.9	0.6

	December 31				
	1981	1982	1983	1984	1985
International reserve position		(billions of SDRs)			
Central Bank (gross)	2.8	2.3	2.6	2.7	4.2
Central Bank (net)	2.4	-1.8	-4.1	-5.9	-6.1
Central Bank and Treasury (net)	2.3	-3.2	-6.1	-8.4	-8.1

1/ GDP in U.S. dollars is derived by converting GDP in australes using the U.S. dollar/austral exchange rate that would maintain the rate at its real 1970 level. GDP in SDRs is obtained by converting this estimate for GDP in U.S. dollars using the actual SDR/U.S. dollar exchange rate.

2/ Change as a percentage of liabilities to the private sector at the beginning of the period.

3/ Includes credit to the nonfinancial public sector and the operating losses of the Central Bank.

4/ Budget commitment basis.

Table 1. Argentina: Projection of IMF Position

	Outstanding June 30, 1985	Operations in 1985 July-Sept.	Operations in 1985 Oct.-Dec.	Operations in 1986 Jan.-Mar.	Operations in 1986 Apr.-June	Outstanding After Full Utilization of 1984 Stand-By Arrangement
Purchases under tranche policies (stand-by arrangement)		473.0	--	236.5	236.5	
Ordinary resources		236.5	--	118.3	118.3	
Enlarged access resources		236.5	--	118.3	118.3	
Repurchases		--	--	--	90.1	
Under tranche policies		--	--	--	25.1	
Under compensatory financing facility		--	--	--	65.0	
Total Fund credit outstanding (end of period)	1,632.1	2,105.1	2,105.1	2,341.6	2,488.0	2,488.0
Under tranche policies	837.0	1,310.0	1,310.0	1,546.5	1,757.9	1,757.9
Under compensatory financing facility	795.1	795.1	795.1	795.1	730.1	730.1
		(In percent of quota)				
Total Fund credit outstanding (end of period)	146.6	189.1	189.1	210.4	223.5	223.5
Under tranche policies	75.2	117.7	117.7	139.0	157.9	157.9
Under compensatory financing facility	71.4	71.4	71.4	71.4	65.6	65.6

Source: Fund staff.

Table 2. Argentina: Selected Economic and Financial Indicators

	1981	1982	1983	1984	Prel. 1985
(Annual percentage change, unless otherwise specified)					
National income and prices					
GDP at constant prices	-6.5	-5.2	3.4	2.4	-4.5
GDP deflator	107.0	184.1	347.5	617.6	652.8
Consumer prices (end of period)	131.3	209.7	433.7	688.0	385.3
General government 1/					
Receipts	78.1	144.4	371.5	647.8	750.5
Outlays	128.8	152.9	439.3	513.7	582.6
External sector (U.S. dollar basis)					
Exports, f.o.b.	14.0	-16.6	2.8	3.5	3.6
Imports, c.i.f.	-10.5	-43.4	-15.6	1.8	-11.6
Export volume	12.6	-1.3	14.7	-2.1	14.7
Import volume	0.4	-42.0	-9.9	4.5	-13.4
Terms of trade (deterioration -)	13.6	-13.4	-4.3	8.4	-11.6
Nominal effective exchange rate 2/ average (depreciation -)	-42.2	-74.2	-77.3	-77.8	-87.5
Real effective exchange rate 2/ average (depreciation -)	-7.8	-44.4	-15.4	17.7	-11.7
year-end (depreciation -)	-34.0	-51.7	22.0	8.8	-14.9
Money and credit					
Domestic credit (net) 3/	119.5	155.0	395.4	554.7	480.7
Private sector	103.6	138.2	280.3	348.0	309.5
Other	15.9	16.9	115.2	206.7	171.2
Financial liabilities to private sector	102.2	109.6	354.6	526.8	429.0
Velocity (GDP relative to private sector liabilities)	-3.8	21.9	36.5	22.8	5.1
Interest rate (compounded annual rate, 30-day deposits)	154.1	124.9	273.1	380.4	301.7
(In percent of GDP)					
General government deficit 1/	-13.0	-13.0	-18.6	-11.2	-4.8
Nonfinancial public sector deficit 1/	-16.7	-18.0	-17.9	-13.1	-4.6
Domestic financing	10.1	14.8	17.7	14.4	4.3
External financing	6.6	3.3	0.2	-1.2	0.3
Gross investment	18.2	18.0	17.9	15.8	15.0
Gross national saving	13.4	12.5	14.0	11.5	12.9
Balance of payments current account (deficit -) 4/	-8.2	-4.1	-4.0	-3.6	-1.9
External debt 4/ 5/	62.0	75.4	74.1	72.3	75.7
Inclusive of Fund credit	62.0	75.4	76.0	73.9	78.6
(In percent of exports of goods and nonfactor services)					
Debt service 6/	54.3	104.1	125.5	98.1	91.4
Interest on external debt 6/	33.1	51.4	56.8	55.1	50.6
(In billions of U.S. dollars)					
Current account of balance of payments	-4.7	-2.4	-2.5	-2.4	-1.3
Overall balance of payments	-3.6	-6.2	-2.6	-1.7	-0.7
Gross official reserves (months of imports)	3.4	5.7	7.3	7.2	13.7
External payments arrears	--	2.5	3.2	4.2	1.6

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

1/ Budget execution basis, except for 1985, which is on a budget basis. Includes extrabudgetary operations, except for 1985.
2/ Measured in terms of foreign exchange per unit of local currency.
3/ Changes in stocks during year relative to liabilities to the private sector at the beginning of the year.
4/ GDP in current U.S. dollars is derived by converting GDP in australes using the U.S. dollar/austral exchange rate that would maintain the rate at its real 1970 level.
5/ Public and private debt, including short term.
6/ From 1982 onward, data indicate amounts due, not amounts actually paid.

Table 3. Argentina: Changes in Expenditure and Output

(Percentage change from previous year)

	1981	1982	1983	1984	1984 IV	1985 I	1985 II	1985 III
(In prices of 1970)								
GDP at market prices	-6.5	-5.2	3.4	2.4	2.8	-1.0	-3.4	-7.8
Gross domestic expenditure	-7.6	-11.6	1.8	3.2	5.7	1.2	-7.7	-12.7
Consumption	-3.2	-10.8	4.0	6.3	5.9	-1.0	-6.7	-10.3
Investment	-23.3	-15.4	-8.6	-13.4	4.6	21.3	-13.7	-29.3
Of which: fixed capital formation	-17.2	-24.6	-1.8	-11.5	-8.3	-5.1	-8.4	-9.4
Exports of goods and nonfactor services	7.9	1.5	8.4	-0.7	-13.6	-8.4	15.1	17.0
Imports of goods and nonfactor services	-3.8	-42.1	-4.7	6.3	11.9	9.1	-13.9	-19.3
(In current prices)								
GDP at market prices	93.2	169.6	362.5	634.9				
Gross domestic expenditure	89.9	159.8	354.6	646.4				
Consumption	100.0	158.1	353.5	669.3				
Investment	54.8	167.5	359.2	548.1				
Exports of goods and nonfactor services	166.1	284.0	404.2	539.9				
Imports of goods and nonfactor services	111.3	179.2	342.8	604.4				

Source: Central Bank of Argentina.

Table 4. Argentina: Performance Under Stand-By Arrangement
Through March 1985

Performance Criterion	Through December 1984 Program Limit	Actual	Margin	Through March 1985 Program Limit	Actual	Margin
	(In millions of pesos argentinos)					
Treasury outlays (from July 1984)	343.5	350.1 1/	-6.6	621.6	742.5 2/	-120.9
Cash deficit of the nonfinancial public sector (from July 1984)	282.1	286.6	-4.5	476.3	572.7	-96.4
Combined deficit of nonfinancial public sector plus the operating result of the Central Bank (from July 1984)	342.3	400.5 3/	-58.2	536.5	859.9 3/	-323.4
Net domestic assets of the Central Bank (stock, end of period)	884.5	894.6	-10.1	-1,006.2	1,131.1	-124.9
	(In millions of U.S. dollars)					
Net international reserves of the monetary authorities (stock, end of period)	-8,850	-8,263	587	-9,570	-9,216	354
External payments arrears (stock, end of period)	4,470	4,162	308	2,760	3,543	-783
Total outstanding disbursed external debt of the public sector (end of period)	39,700	34,104	5,596	39,700	34,607	5,093
Cumulative net disbursement of short-term debt of the public sector contracted after September 30, 1984	2,500	74	2,426	2,500	118	2,382
	(In percent per month)					
Regulated interest rate on deposits of 30 days or more (quarterly average)	17.37	17.40	0.03	22.53	18.52	-4.01

Sources: Data provided by Argentine authorities.

1/ According to understandings between the Fund staff and Argentine officials, it includes an estimated ₳ 21.4 million of National Administration salaries due in December 1984 for which the order to pay had not been issued by the end of the month.

2/ Includes ₳ 13.3 million in employer contributions by the National Administration to the social security system due but not paid in the first quarter of 1985.

3/ Data for the operating result of the Central Bank include, in addition to the results reflected in the balance sheet of the Central Bank, an estimate of recoverable income accrued on central bank rediscounts to financial institutions in the process of being liquidated (₳ 2.3 million in the second half of 1984 and ₳ 56.7 million in the first quarter of 1985).

Table 5. Argentina: Performance Under Stand-by Arrangement in the Third Quarter of 1985

Performance criterion	Through July 31, 1985			Through September 30, 1985		
	Program Limit	Actual	Margin	Program Limit	Actual	Margin
	(In millions of australes)					
Treasury outlays (since June 30, 1985) 1/	550.0	549.9	0.1	1,630.0	1,644.0 2/	-14.0
Cash deficit of nonfinancial public sector (since June 30, 1985)	50.0	41.2	8.8	105.0	248.0	-143.0
Combined deficit of nonfinancial public sector and operating result of the Central Bank (since June 30, 1985)	100.0	97.2	2.8	260.0	399.0	-139.0
Net domestic assets of the Central Bank (change since June 30, 1985)	512.6 3/	290.0	222.6	816.4 3/	662.0	154.4
	(In millions of U.S. dollars)					
Net international reserves of the monetary authorities (stock, end of period)	-9,015	-8,578	437	-9,217	-8,498 4/	719
External payments arrears (stock, end of period)	3,650	3,180	470	1,800	2,427	-627
Total outstanding disbursed external debt of the public sector (end of period)	39,700	35,030	4,670	39,700	35,654	4,046
Cumulative net disbursements of short-term debt of the public sector contracted after September 30, 1984	2,500	183	2,317	2,500	215	2,285
	(In percent per month)					
Regulated interest rate on deposits of 30 days or more	2.38 5/	3.62 5/	1.24	1.28 6/	3.35 6/	2.07

Source: Data provided by Argentine authorities.

1/ Includes certain extrabudgetary operations on a gross basis.

2/ The original projection of Treasury spending included ₳ 55 million to reflect the operations of a revolving fund for the Social Security System that was to be set up following approval of the 1985 budget. It was agreed with Argentine officials in July 1985 that if this revolving fund was not created, the estimate of Treasury spending would be adjusted to ensure that use of a different accounting procedure did not result in a loosening of the program limit; in the event, the revolving fund for the Social Security System was not created and the estimate of Treasury spending has been revised upward by ₳ 55 million.

3/ Includes an upward adjustment to allow for revisions to the estimate of Central Bank monetary liabilities for the base period of June 1985.

4/ Includes a downward adjustment of US$150 million to compensate for a reduction in the estimate of external payments arrears corresponding to operations prior to the beginning of the program period.

5/ Average of July and August.

6/ Average of September and October.

Table 6. Argentina: Operations of the Nonfinancial Public Sector 1/

(In percent of GDP)

	1983	1984	1985	1983 Semester I	1983 Semester II	1984 Semester I	1984 Semester II	1985 Semester I	1985 Semester II
I. National Administration 2/									
Revenue 3/	15.3	15.4	16.7	19.3	13.9	14.7	15.7	12.5	18.9 4/
Expenditure	12.4	10.4	10.3	12.0	12.5	10.6	10.4	9.9	10.5
Current	10.3	9.6	9.4	10.1	10.4	9.8	9.6	9.4	9.5
Wages and salaries	4.0	4.2	4.0	3.2	4.2	4.4	4.2	4.0	3.9
Goods and nonpersonal services	1.5	1.2	1.1	1.4	1.5	1.2	1.1	0.8	1.3
Transfers 5/	1.3	1.1	1.2	1.1	1.4	1.1	1.0	1.1	1.2
Pensions and private schools teachers' salaries	0.9	0.8	0.8	0.8	0.9	0.9	0.8	0.8	0.9
Other	0.4	0.3	0.4	0.3	0.5	0.2	0.2	0.3	0.3
Interest	3.2	2.9	3.0	3.6	3.0	2.9	2.9	3.5	2.8
Domestic	0.4	0.2	0.1	0.6	0.4	0.2	0.2	0.1	0.2
External	2.8	2.7	2.9	3.0	2.7	2.6	2.7	3.4	2.6
Miscellaneous	0.4	0.3	0.1	0.7	0.3	0.2	0.3	--	0.2
Capital	2.1	0.8	0.9	2.0	2.1	0.8	0.8	0.6	1.0
Current surplus	5.0	5.8	7.2	9.2	3.5	4.9	6.1	3.1	9.4
Overall surplus	3.0	5.0	6.4	7.2	1.4	4.1	5.3	2.5	8.4
II. Provinces and Municipality of Buenos Aires (MCBA)									
Revenue 3/ 6/	4.1	4.7	4.9	4.9	3.7	4.9	4.7	5.3	4.8
Expenditure	9.9	11.3	10.6	9.6	10.1	11.1	11.3	10.2	10.8
Current	7.7	8.5	7.9	6.9	7.9	8.3	8.5	7.5	8.1
Wages and salaries	4.9	5.7	5.2	3.8	5.3	5.6	5.7	5.0	5.3
Goods and nonpersonal services	0.6	0.9	0.9	0.7	0.5	0.9	0.9	0.9	0.9
Transfers 5/	2.1	1.9	1.8	2.2	2.0	1.9	1.9	1.6	1.9
Pensions and private schools teachers' salaries	--	1.2	0.7	--	--	1.2	1.2	0.6	0.6
Other	2.1	0.6	1.1	2.2	2.0	1.7	1.7	1.0	1.2
Interest	0.2	--	--	0.2	0.2	--	--	--	--
Domestic	--	--	--	0.1	--	--	--	--	--
External	0.1	--	--	0.1	0.2	--	--	--	--
Miscellaneous	--	--	--	--	--	--	--	--	--
Capital	2.3	2.8	2.7	2.7	2.1	2.8	2.8	2.7	2.7
Current deficit (-)	-3.6	-3.7	-3.0	-2.0	-4.3	-3.4	-3.8	-2.3	-3.3
Overall deficit (-)	-5.9	-6.5	-5.6	-4.6	-6.3	-6.3	-6.6	-4.9	-6.0
III. Social Security System									
Revenue 3/ 7/	2.8	2.7	3.9	3.0	2.7	2.4	2.8	3.5	4.1
Current expenditure	6.0	5.5	5.6	5.7	6.1	5.5	5.6	4.5	6.1
Overall deficit (-)	-3.2	-2.9	-1.7	-2.7	-3.4	-3.1	-2.8	-1.0	-2.0

Table 6. Argentina: Operations of the Nonfinancial Public Sector 1/ (Concluded)

(In percent of GDP)

	1983	1984	1985	1983 Semester I	1983 Semester II	1984 Semester I	1984 Semester II	1985 Semester I	1985 Semester II
IV. Public Enterprises									
Revenue	9.5	8.7	11.0	10.0	9.3	8.9	8.6	8.3	12.5
Expenditure	14.0	12.5	14.7	16.5	13.1	13.4	12.3	13.0	15.7
Current	10.8	10.1	12.3	13.2	9.9	10.7	9.9	11.0	12.9
Wages and salaries	2.5	2.6	2.8	2.5	2.5	2.9	2.5	2.8	2.9
Goods and nonpersonal services	4.9	5.2	6.4	5.9	4.6	5.2	5.2	5.0	7.1
Interest	2.3	2.0	2.4	3.6	1.9	2.3	1.9	2.9	2.1
Domestic	0.5	0.3	0.6	1.2	0.2	0.5	0.2	0.8	0.5
External	1.9	1.7	1.8	2.4	1.7	1.8	1.7	2.1	1.7
Miscellaneous	1.0	0.2	0.7	1.2	1.0	0.3	0.2	0.4	0.8
Capital	3.2	2.5	2.5	3.3	3.1	2.7	2.4	2.0	2.7
Current deficit (-)	-1.5	-1.5	-1.3	-3.2	-0.9	-1.8	-1.4	2.8	-0.5
Overall deficit (-)	-4.5	-3.9	-3.7	-6.5	-3.8	-4.5	-3.7	-4.7	-3.2
V. Nonfinancial Public Sector									
Revenue 3/8/	22.4	22.9	25.6	27.3	20.6	22.4	23.1	21.4	27.8
Expenditure 9/	33.0	31.2	30.4	33.9	32.7	32.1	30.9	29.5	30.8
Current	25.5	25.2	24.4	25.9	25.4	25.8	25.0	24.2	24.4
Capital	7.5	6.1	6.0	8.0	7.3	6.3	6.0	5.3	6.4
Current surplus or deficit (-)	-3.1	-2.3	1.2	1.4	-4.7	-3.4	-1.9	-2.8	3.4
Overall deficit (-)	-10.6	-8.3	-4.8	-6.6	-12.0	-9.7	-7.8	-8.1	-3.0
Memorandum items 10/									
Expenditure	42.3	39.8	41.4	43.8	41.7	40.6	39.5	37.7	43.4
Of which:									
Wages and wage related	18.2	20.1	19.0	16.0	19.0	20.4	20.0	17.7	19.7
Interest	5.7	5.0	5.5	7.4	5.1	5.2	4.9	6.4	5.0
Net intrasector transfers (paid -)									
National Administration	-13.2	-11.6	-10.1	-14.5	-12.7	-12.0	-11.5	-9.9	-10.2
Provinces and MCBA	5.9	6.0	5.7	5.7	6.0	5.4	6.2	5.1	6.0
Public Enterprises	5.0	3.5	2.7	6.3	4.5	3.9	3.4	2.8	2.6
Social Security	2.4	2.2	1.7	2.5	2.3	2.8	2.0	2.0	1.5

Sources: Ministry of Economy; and Fund staff estimates.

1/ On a cash basis, except for external interest which is on an accrual basis.
2/ Includes Central Administration, special accounts, and decentralized agencies.
3/ Includes capital revenue.
4/ Includes receipts from the compulsory savings plan.
5/ Excludes intra public sector transfers.
6/ Does not include transfers from the Treasury to the provinces under the revenue-sharing plan.
7/ Does not include transfers from the Treasury out of general revenue to compensate for the reduction from its 1980 level in the rate for employers' contributions to the Social Security System.
8/ Excludes current revenue of public enterprises.
9/ Includes current account deficits of public enterprises.
10/ Includes public enterprises on a gross basis.

Table 7. Argentina: Comparison of 1985 and 1986 Budget Plans 1/

(In billions of 1986 australes) 2/

	1985				1986			
	National Administration	Provinces and Municipality of Buenos Aires	Social Security System	Nonfinancial Public Sector	National Administration	Provinces and Municipality of Buenos Aires	Social Security System	Nonfinancial Public Sector
Revenues	11.1 3/	3.2 4/	2.7 5/	17.0	12.1 3/	3.3 4/	2.9 5/	18.4
Expenditures	7.6	6.6	3.5	20.4	7.8	6.6	3.9	20.3
Current	6.6	4.9	3.5	15.6	6.6	4.7	3.9	15.0
Wages and salaries	2.4	3.2	--	5.5	2.5	2.9	--	5.4
Goods and nonpersonal services	1.5	0.7	--	2.2	1.5	0.7	--	2.2
Transfers	1.2	1.0	3.5	5.7	1.6	1.0	3.9	6.5
Interest	1.8	--	--	1.8	1.5	--	--	1.5
Operating losses of public enterprises	--	--	--	0.7	--	--	--	-0.2
Miscellaneous 6/	-0.2	--	--	-0.2	-0.3	--	--	-0.4
Capital	1.0	1.7	--	4.8 7/	1.1	1.9	--	5.3 7/
Overall deficit	3.5	-3.4	-0.8	-3.5	4.4	-3.3	-1.0	-1.9

Source: Ministry of Economy.

1/ Commitment basis.
2/ Assumes that prices increase by 28 percent from December 1985 to December 1986.
3/ Includes receipts from compulsory savings plan.
4/ Does not include transfers from the Treasury to the provinces under the revenue-sharing plan.
5/ Does not include transfers from the Treasury out of general revenue to compensate for the reduction from its 1980 level in the rate for employers' contributions to the Social Security System.
6/ Includes underutilization of budgetary allocations.
7/ Includes capital expenditure of the public enterprises.

Table 8. Argentina: Summary of Operations of Financial Systen

	December			
	1981	1982	1983	198
I. Consolidated Financial System				
(Percentage change during previous 12 months)				
Net domestic assets 1/	120.6	185.1	405.1	55
Private sector	103.6	138.2	280.3	34
Nonfinancial public sector	53.7	68.8	210.2	14
Other 2/	-36.7	-21.9	-85.4	5
Liabilities to private sector	102.2	109.6	354.6	52
Monetary libilities	69.7	220.3	368.2	52
Other liabilities	114.2	80.5	349.2	52
(Change during previous 12 months, in millions of U.S. dollars				
Net foreign assets	-4,214	-7,316	-2,485	-
II. Central Bank				
(Percentage change during previous 12 months)				
Net domestic assets 3/	181.6	1059.0	415.4	4
Private sector	127.4	874.3	227.3	3
Nonfinancial public sector	134.8	212.5	272.2	1
Other 2/	-80.7	-27.9	-84.0	-
Liabilities to financial system and nonfinancial private sector	117.5	744.0	356.2	4
Nonfinancial private sector	86.1	185.8	427.1	5
Rest of financial system	186.6	1,542.5	338.6	3
(Change during previous 12 months, in millions of U.S. dollar				
Net foreign assets	-3,427	-7,089	-2,434	-1

Source: Central Bank of Argentina.

1/ Change as a percentage of liabilities to the private sector at the be
period.
2/ Includes counterpart to unrequited foreign exchange transactions (inc
allocations and valuation adjustments).
3/ Change as a percentage of central bank liabilities at the beginning c

Table 9. Argentina: Balance of Payments

(In millions of U.S. dollars)

	1980	1981	1982	1983	1984	1985 Prog.	1985 Est.
nt account	-4,768	-4,714	-2,358	-2,461	-2,391	-1,741	-1,260
balance	-2,519	-287	2,287	3,331	3,523	4,058	4,348
orts, f.o.b.	8,021	9,143	7,624	7,836	8,107	8,708	8,398
orts, c.i.f.	-10,540	-9,430	-5,337	-4,505	-4,584	-4,650	-4,050
ces and transfers	-2,249	-4,427	-4,645	-5,792	-5,914	-5,799	-5,608
vel	-1,447	-1,058	44	-60	-80	-122	-194
ancial services	-1,531	-3,699	-4,719	-5,408	-5,712	-5,537	-5,331
er	729	330	30	-324	-122	-140	-83
al account	2,261	1,155	-3,808	-111	647	91	597
t investment	788	927	257	183	268	653	921
ng sector 1/	-403	257	519	326	-594	237	...
financing	-115	-3,385	-2,270	-411	501	-512	...
public sector 2/	2,957	4,535	-516	302	2,261 3/	2,996 3/	...
private sector 4/	-1,040	-1,249	-1,348	-511	-1,789 3/	-3,283 3/	...
llocation	74	70	--	--	--	--	--
ll balance	-2,507	-3,559	-6,166	-2,572	-1,744	-1,650	-663
tion adjustment	-213	-363	-105	-260 5/	-145 5/	-21	82
e in net international erves (increase -)	2,720	3,922	6,271	2,832	1,889	1,671	581
e in assets (increase -)	2,993	3,458	680	-129	34	-1,475	-1,858
osition (net)	-136	63	178	1,273	-34	1,218	1,007
e in other reserve abilities	-137	401	2,873	1,006	948	4,990	3,955 6/
e in arrears	--	--	2,540	682	941	-3,062	-2,523
randum items							
rest payments	2,175	3,850	4,926	5,422	5,537	5,307	5,161
nce of goods, nonfactor rvices, and transfers	-3,237	-1,015	2,361	2,946	3,221	3,796	4,071

urce: Central Bank of Argentina.

Includes changes in foreign assets not considered part of international reserves.
Includes Argentine government bonds denominated in foreign currencies. Except where noted, does reflect change of liabilities from private sector to Government in respect of matured loans with ange rate guarantees.
Includes the assumption of private sector obligations by the public sector in connection with the restructuring agreements.
Includes errors and omissions.
Includes adjustments for operations recorded in net international reserves which do not espond to balance of payments flows of the period.
Includes an adjustment of US$150 million corresponding to a reduction in the estimate of external ent arrears outstanding at the beginning of 1985.

Table 10. Argentina: External Payments Arrears 1/

(In millions of U.S. dollars)

	1982	1983	1984			19	
	Dec.	Dec.	June	Sept.	Dec.	March	June
Total	2,540	3,222	4,378	4,234	4,163	3,543	3,338
Public sector	2,001	2,028	3,588	3,527	3,424	2,848	2,717
Commercial arrears 2/	777	902	1,960	1,274	1,477	329	141
Principal	...	771	1,772	1,040	1,191	273	100
Interest	...	131	188	234	286	56	41
Financial arrears	879	773	1,184	1,762	1,369	1,890	1,899
Principal	65	43	13	--	5	--	--
Interest 3/	814	730	1,171	1,762	1,364	1,890	1,899
Other arrears 5/	345	353	444	491	578	629	677
Private sector	539	1,194	790	707	739	695	621
Commercial arrears 2/	382	880	270	45	47	32	27
Principal	...	752	230	39	39	32	27
Interest	...	128	40	6	8	--	--
Financial arrears	118	191	431	543	554	522	439
Principal	95	65	102	124	138	138	147
Interest	23	126	329	419	416	384	292
Other arrears 3/	39	123	89	119	138	141	155
Memorandum item							
Accrued interest on BONOD and promissory notes	--	217	329	415	338	395	473

Source: Central Bank of Argentina.

1/ Excludes the arrears referred to in the footnotes to Table 4 of the February 2(from the Argentine authorities.
2/ Arrears related to imports.
3/ Includes interest accrued on BONOD and promissory notes issued with respect to guaranteed loans, but not yet taken up by the foreign creditor or domestic debtor.
4/ Includes a downward adjustment arising from the revision of the estimated stoc covered by exchange guarantee which in turn gives rise to a corresponding downward r million in the interest arrears accrued on these loans.
5/ Primarily arrears on services and transfers.

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Table 11. Argentina: International Reserves of the Monetary Authorities

(In millions of U.S. dollars; end of period)

	1981	1982	1983	1984 June	1984 Sept.	1984 Dec.	1985 March	1985 June	1985 Sept.	1985 Dec.
al net interna-ional reserves	2,684	-3,551	-6,383	-6,824	-7,449	-8,272	-9,196	-8,985	-8,459	-8,907
tral Bank	2,699	-1,953	-4,293	-4,494	-5,026	-5,796	-6,970	-6,749	-6,216	-6,649
:ets	3,186	2,542	2,671	3,421	2,882	2,637	2,297	3,053	4,383	4,639
old 1/	185	185	1,421	1,421	1,421	1,421	1,421	1,421	1,421	1,421
;DRs	401	--	23	37	23	26	27	--	7	13
MF reserve tranche	276	100	--	--	--	--	--	--	--	--
'oreign exchange 2/	2,548	2,441	1,172	1,741	1,353	1,243	817	1,720	2,918	3,111
.AIA (net) 3/	-224	-184	55	222	85	-53	32	-88	37	94
.bilities	487	4,495	6,964	7,915	7,908	8,433	9,267	9,802	10,599	11,288
MF	--	--	1,173	1,173	1,173	1,139	1,603	1,629	2,228	2,289
'ayments arrears	--	2,540	3,222	3,778	4,233	4,163	3,542	3,338	2,435	1,640
'oreign currency swaps	484	1,380	1,228	1,061	953	937	937	937	888	730
;alance of payments support loans	--	121	1,298	1,805	1,390	1,873	2,806	3,502	4,638	6,629
To Central Bank	--	--	1,250	1,775	1,350	1,850	1,250	1,733	2,796	3,597
Via residents 4/	--	121	48	30	40	23	24	21	10	5
Paris Club rescheduling	--	--	--	--	--	--	1,532	1,748	1,832	2,027
)ther liabilities	3	454	43	98	159	321	379	396	410	1,000
:asury liabilities 5/	15	1,598	2,090	2,330	2,423	2,476	2,226	2,236	2,243	2,258

;ource: Central Bank of Argentina.

_/ Valued at US$42 per fine troy ounce through December 6, 1983 and at US$325 thereafter.
'/ On December 6, 1983, US$1.2 billion in Central Bank foreign claims on Banco de la Nación and the responding Banco de la Nación claims on the Argentine public sector were cancelled and replaced by iestic claims of the Central Bank on the public sector.
;/ Balances under the multilateral clearing system of the Latin American Integration Association .IA).
./ Reflects external obligations of residents, the foreign currency proceeds of which were rendered to the Central Bank without the borrowing entity receiving the counterpart in pesos.
,/ Foreign currency bonds (BONEX) issued in lieu of providing foreign exchange to effect external ments. Such bonds are issued upon the surrender of the peso equivalent of the external payment.

Table 12. Argentina: Financing of the Balance of Payments, January 1985-March 1986

(In millions of U.S. dollars)

	1985	First Quarter of 1986	January 1985-March 1986
Balance of payments deficit	663	878	1,541
Increase in gross reserves	1,858	-902	956
Decrease in arrears	2,523	590	3,113
Total	5,044	566	5,610
IMF	1,007	263	1,270
Paris Club refinancing 1/	2,012	29	2,041
Loans from governments	-600	--	-600
Loans from banks	2,047	508	2,557
1982 bridge loan	-750	--	-750
1985 new money package	3,096	600	3,696
Other 2/	-299	-92	-391
Government bonds (BONEX)	-217	-333	-550
Other liabilities of the Central Bank 3/	795	99	894

Source: Fund staff estimates.

1/ Includes the working assumption that obligations due to Paris Club creditors in the first quarter of 1986 will be rescheduled on terms similar to those for obligations rescheduled in 1985.

2/ Includes swaps, reserve loans, and certificates of deposit of banks held in connection with the 1985 refinancing agreement (includes Circulars A404, A562, A576, A696, and A697).

3/ Includes the balance with the Latin American Integration Association (LAIA), certificates of deposit of nonbank creditors held in connection with refinancing of private sector debt (includes Circulars A404, A 562, A576, A696, and A697), and other central bank liabilities.

Table 13. Argentina: External Debt and Debt Service

	1980	1981	1982	1983 1/	1984	Est. 1985
(In millions of U.S. dollars; end-year)						
Total external debt 2/	27,162	35,671	43,634	46,005	47,821	49,528
By borrowing sector						
Public sector	14,459	20,024	28,616	33,176	37,628	42,791
Private sector	12,703	15,647	15,018	12,829	10,193	6,737
By maturity						
Medium and long term	16,877	26,067	28,784	31,327	...	...
Short term	10,285	9,604	12,310	11,456	...	...
Arrears	--	--	2,540	3,222	4,163	1,640
Debt service 3/	3,525	6,307	9,971	11,984	9,858	9,330
Interest	2,175	3,850	4,926	5,423	5,537	5,161
Amortization	1,350	2,457	5,045	6,561	4,321	4,169
(Ratios)						
Debt service ratio	32.5	54.3	104.1	125.5	98.1	91.4
Interest	20.0	33.1	51.4	56.8	55.1	50.6
Amortization	12.4	21.2	52.7	68.7	43.0	40.8
Debt/GDP 4/	48.4	62.0	74.7	74.1	72.3	75.7
Interest payments/GDP 4/	3.9	6.7	8.5	8.7	8.4	8.1

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

1/ Data for 1983 are based on a new debt reporting system, and are not directly comparable with data for previous years. Data for 1984 and 1985 are constructed using the 1983 base and the balance of payments flows.

2/ Data for end-1982 incorporate a US$3.7 billion upward adjustment due to inclusion of previously unreported public sector debt. Data from 1983 onward take into account shifts in liabilities from the private to the public sector related to the maturing of loans covered by exchange rate guarantees (US$1.4 billion in 1982, US$1.4 billion in 1983, US$5.4 billion in 1984, and US$0.9 billion in 1985).

3/ Includes amortization on loans with an original maturity of more than one year and all interest payments. Includes both public and private debt. Data for 1982-85 reflect amounts due rather than amounts actually paid.

4/ Debt at end of year over GDP in the year. GDP in U.S. dollars is derived by converting GDP in australes using the U.S. dollar/austral exchange rate that would maintain the rate at its real 1970 level.

Table 14. Argentina: Maturity Structure of Estimated External Debt as of End-1985

(In millions of U.S. dollars)

	Estimated Debt Outstanding at End-1985	End-1985 Arrears	Falling Due 1986	1987	1988	1989	1990	1991	1992	1993 and After
Total	49,528	1,640	9,265	6,177	5,008	4,501	3,475	3,513	3,724	12,225
IMF	2,311	--	370	543	419	516	285	97	81	--
Multilateral organizations	1,994	--	218	206	194	180	177	167	137	715
Bilateral creditors	3,238	357	304	311	299	388	295	388	354	542
Paris Club refinancing	2,012	--	126	126	115	214	198	345	346	542
Other	1,226	357	178	185	184	174	97	43	8	--
Bonds	3,844	--	620	626	561	621	594	457	348	17
Banks	33,670	570	6,125	4,124	3,215	2,594	1,910	2,202	2,610	10,320
BONOD and promissory notes	4,833	--	1,099	1,791	921	168	168	168	168	350
1985 refinancing	12,915	--	--	18	316	515	882	1,380	1,846	7,958
1985 new money	3,096	--	--	--	26	552	130	208	390	1,790
Other 1/	12,826	570	5,026	2,315	1,952	1,359	730	446	206	222
Other creditors 2/	4,471	713	1,628	367	320	202	214	202	194	631
BONOD and promissory notes	308	--	70	114	59	11	11	11	11	21
1985 refinancing	496	--	--	--	66	66	66	66	66	166
Other	3,667	713	1,558	253	195	125	137	125	117	444

Source: Central Bank of Argentina.

1/ Includes trade-related lines of credit.
2/ Includes suppliers' credits.

Table 15. Argentina: Balance of Payments Projections, 1985-90

	Actual 1985	1986	1987	1988	1989	1990
	(In millions of U.S. dollars)					
Current account	-1,260	-2,337	-1,418	-998	-460	230
Trade balance	4,348	3,143	4,137	4,685	5,302	5,997
Exports	8,398	7,793	9,215	10,256	11,415	12,705
Imports	-4,050	-4,650	-5,078	-5,572	-6,113	-6,708
Nonfactor services	-277	-323	-346	-370	-396	-424
Factor services	-5,331	-5,157	-5,209	-5,313	-5,366	-5,343
Financing	1,260	2,337	1,418	998	460	-230
Nondebt creating flows	921	610	800	900	1,200	1,200
Other capital	3,713	2,854	861	642	121	-760
Disbursements	...	8,349	6,848	4,935	4,762	3,741
Amortization	...	-5,495	-5,987	-4,293	-4,641	-4,502
Change in gross official international reserves (increase -)	-1,858	410	300	-125	-200	-192
Use of IMF credit	1,007	103	-543	-419	-661	-478
Change in arrears	-2,523	-1,640	--	--	--	--
	(In percent)					
Debt service as a percent of exports of goods, nonfactor services and transfers	91.4	111.0	98.7	79.9	76.4	66.5
Interest	50.6	51.3	43.8	39.7	35.8	31.7
Amortization 1/	40.8	59.7	54.9	40.1	40.6	34.7
Current account balance/GDP	-1.9	-3.4	-1.9	-1.2	-0.5	0.2
Interest payments/GDP	7.9	7.2	6.6	6.1	5.7	5.2
External debt/GDP 2/	75.7	73.7	68.6	63.7	58.3	52.6
	(In months of merchandise imports)					
Reserves 3/						
Gross reserves	13.7	10.9	9.3	8.7	8.4	8.0
Disposable reserves 4/	7.2	5.2	4.0	4.0	4.0	4.0
	(In billions of U.S. dollars)					
Debt service payments	9.4	10.7	11.1	10.0	10.6	10.2
Interest	5.2	5.0	4.9	5.0	5.0	4.9
Amortization	4.2	5.8	6.2	5.0	5.6	5.3
Exports of goods, nonfactor services, and transfers	10.2	9.7	11.3	12.5	13.8	15.4
External debt	49.5	50.8	51.2	51.4	50.8	49.6
Gross domestic product	65.4	68.9	74.6	80.7	87.2	94.4

Source: Fund staff estimates.

1/ Includes only amortization of obligations with original maturity of one year or more.
2/ Stock of debt at year-end relative to GDP for the year.
3/ Stock of reserves at year-end in months of merchandise imports for the year.
4/ Defined as readily available short-term deposits not tied to the funding of operations of Argentine banks abroad.

Table 16. Argentina: Quantitative Performance Criteria for end-March 1986

Limit on change in the net domestic assets of the Central Bank in the first quarter of 1986 (in millions of australes)	1,042
Limit on change in net international reserves of the monetary authorities in the first quarter of 1986 (in millions of U.S. dollars) 1/	-878
Limit on cash deficit of the nonfinancial public sector in the first quarter of 1986 (in millions of australes)	443
Limit on cash deficit of the nonfinancial public sector plus operating result of the Central Bank in the first quarter of 1986 (in millions of australes)	593
Limit on treasury outlays in the first quarter of 1986 (in millions of australes)	1,812
Limit on total outstanding disbursed external debt of the public sector (in millions of U.S. dollars)	39,700
Limit on cumulative net disbursements of short-term debt of the public sector contracted after September 30, 1984 (in millions of U.S. dollars)	2,500
Limit on outstanding external payments arrears (in millions of U.S. dollars)	1,050

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

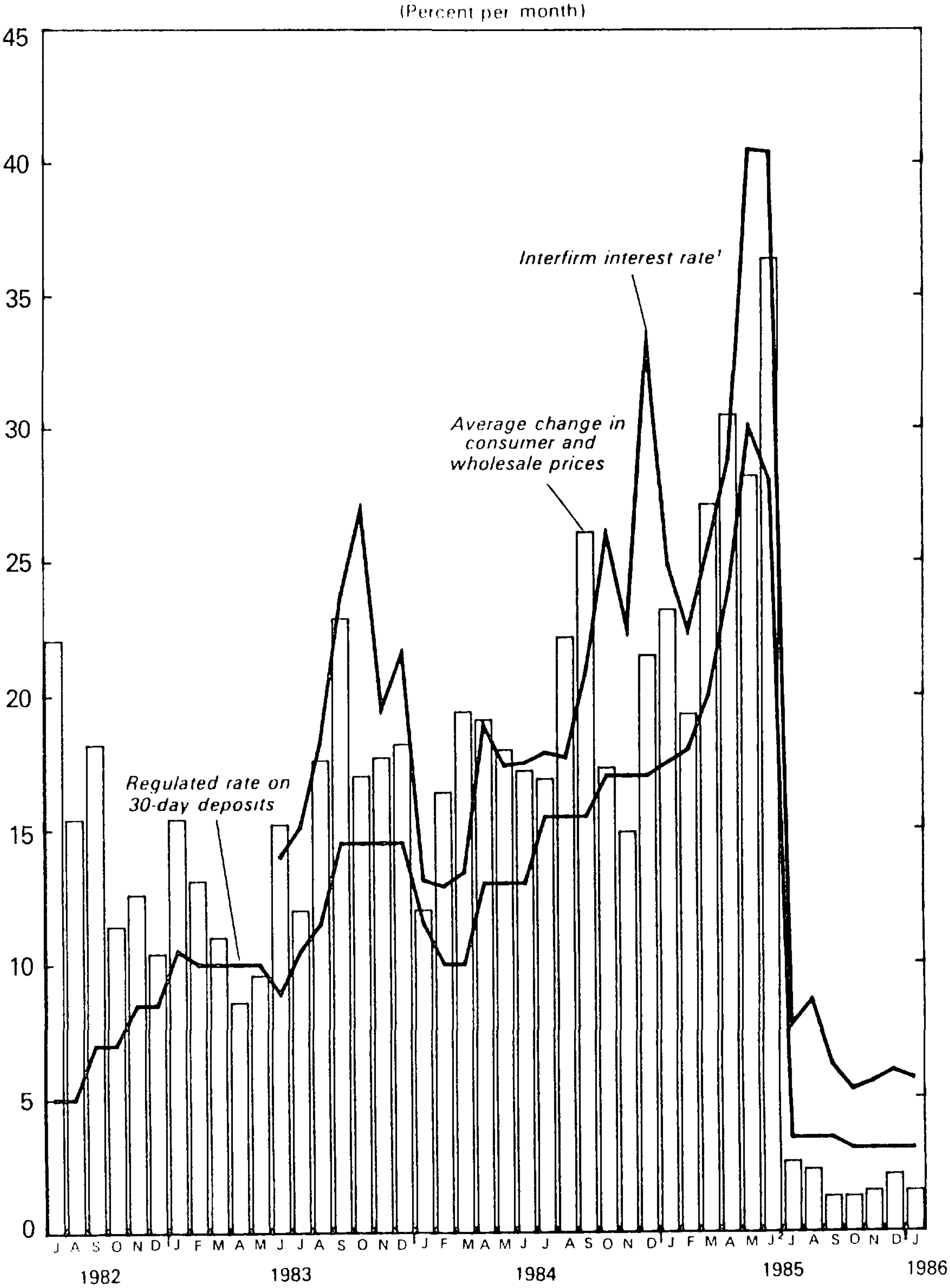
1/ Assets and liabilities in currencies other than the U.S. dollar are converted into U.S. dollars at market exchange rates of December 31, 1985; gold is valued at US$325 per fine troy ounce.

CHART 1

ARGENTINA

INTEREST RATES AND INFLATION

(Percent per month)



Sources: Central Bank of Argentina and National Institute of Statistics.

[1] For loans against security of Bonex.

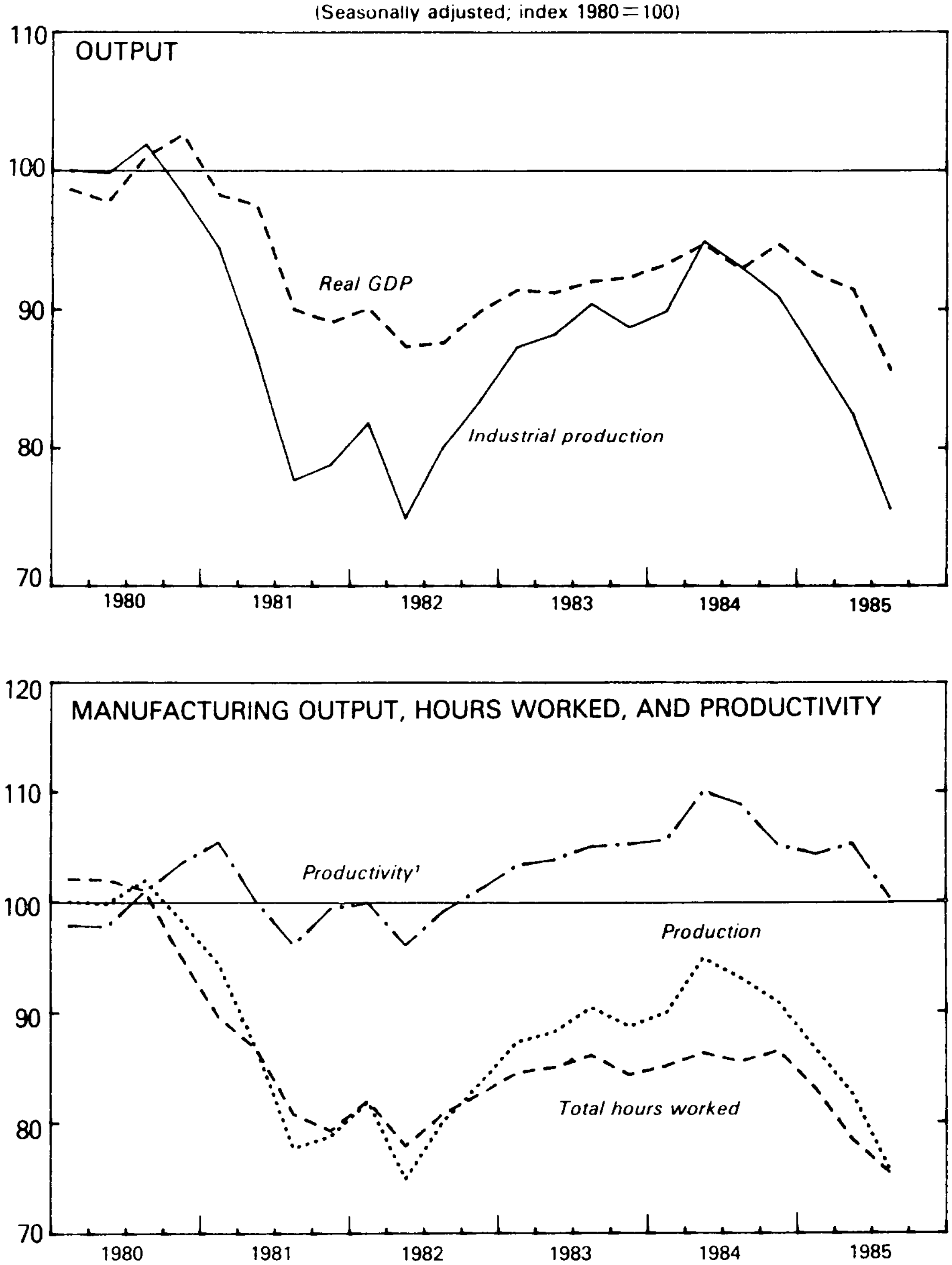
[2] Interest rate data for first half of June.

CHART 2

ARGENTINA

OUTPUT AND EMPLOYMENT

(Seasonally adjusted; index 1980=100)



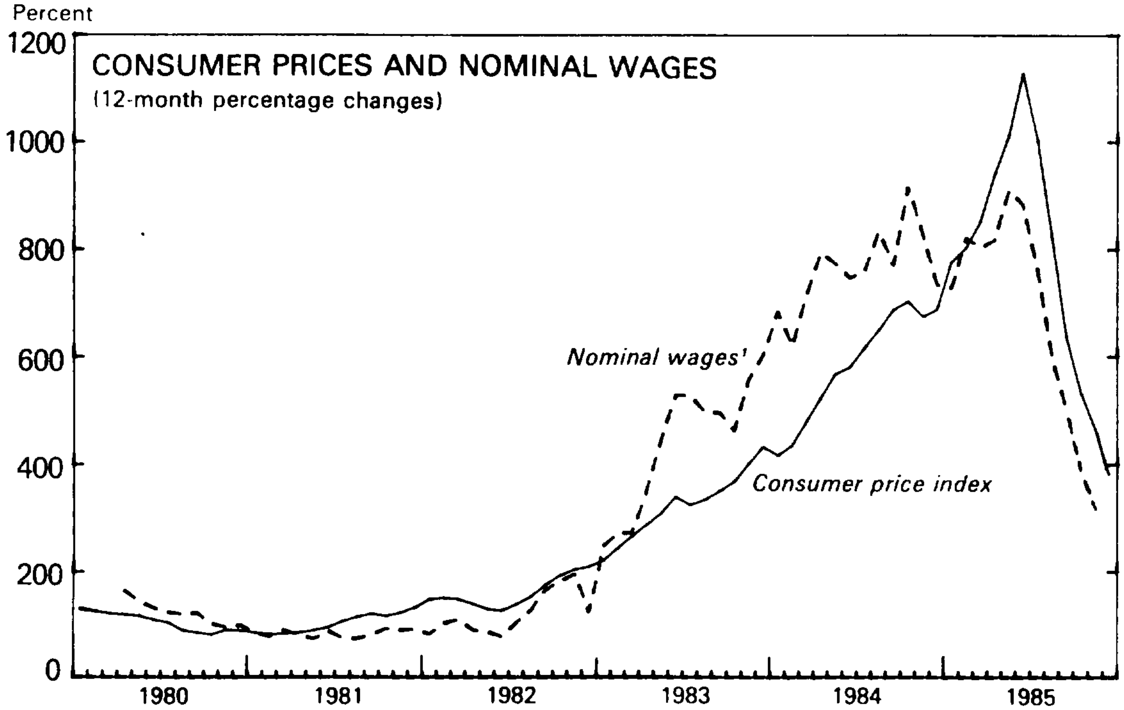
Source: Central Bank of Argentina.

[1] Output per manhour.

CHART 3

ARGENTINA

PRICE AND WAGE DEVELOPMENTS

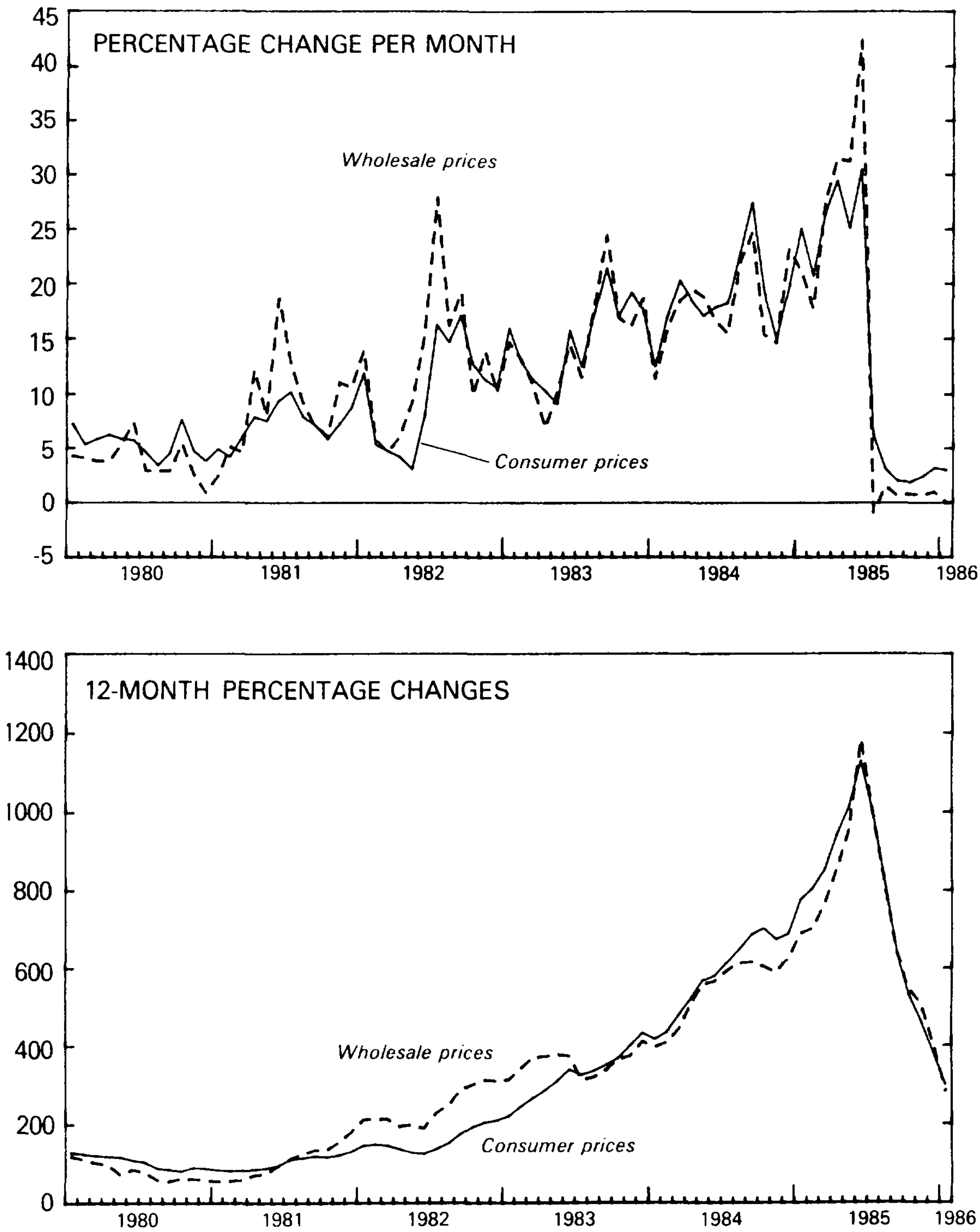


Sources: Central Bank of Argentina and National Institute of Statistics.
[1]Total remuneration per employee in manufacturing industry (excluding regular semiannual bonus).
[2]Seasonally adjusted total remuneration per employee (excluding bonus), deflated by consumer price index.

CHART 4

ARGENTINA

CONSUMER AND WHOLESALE PRICES



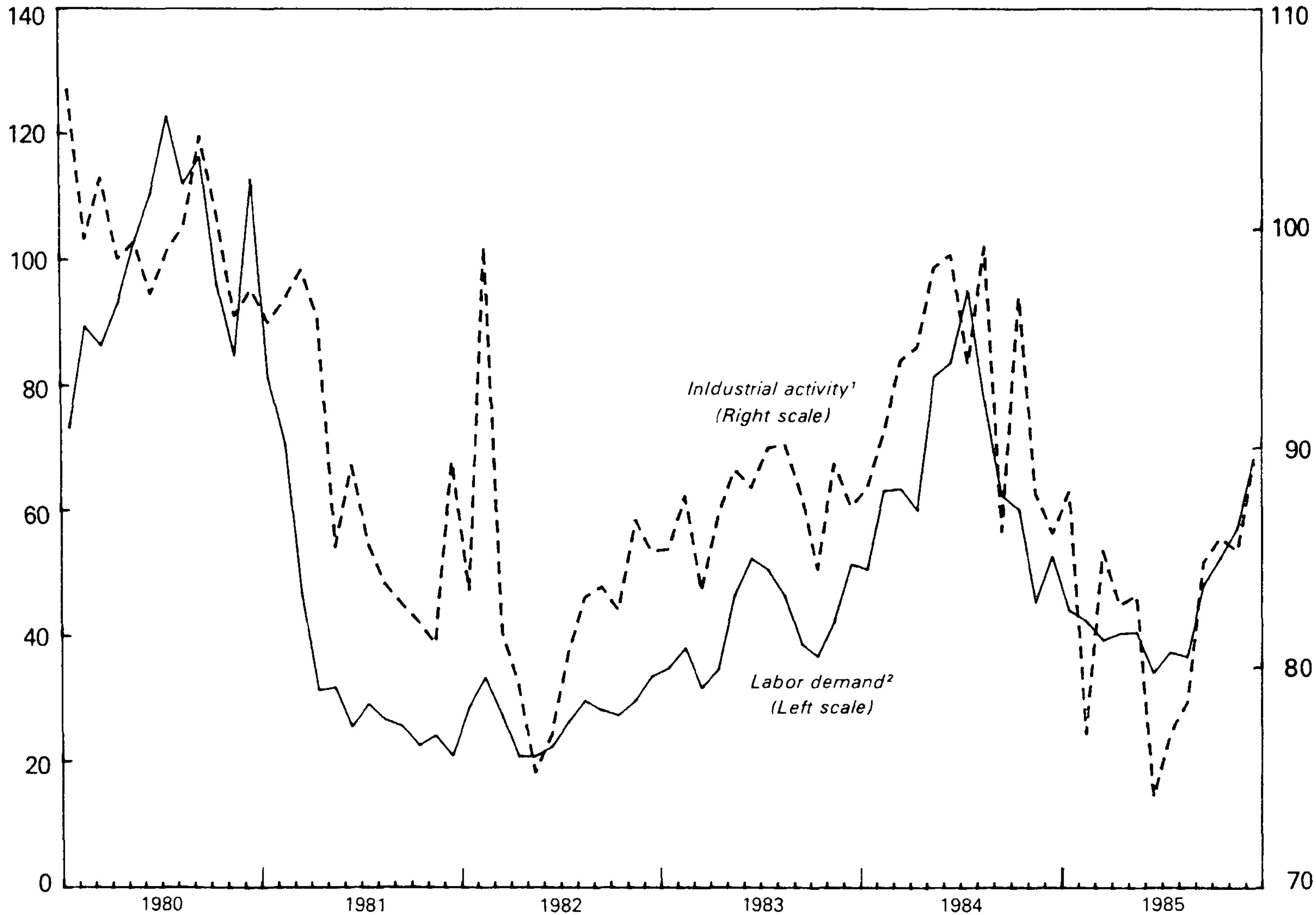
Source: National Institute of Statistics.

CHART 5

ARGENTINA

INDICATORS OF INDUSTRIAL ACTIVITY AND LABOR DEMAND

(Indexes 1980 = 100)



Sources. Central Bank of Argentina and National Institute of Statistics.

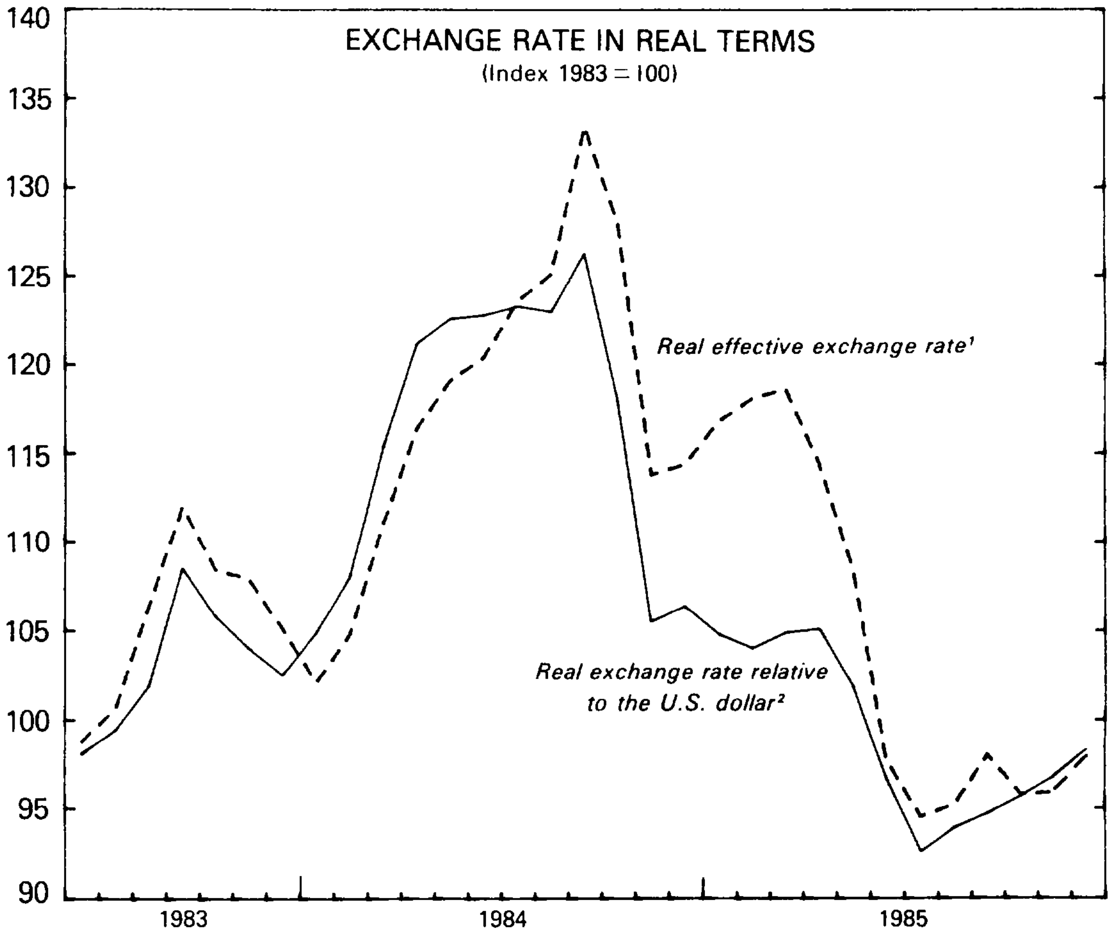
[1] Based on the production of a sample of firms that represent about 25 percent of industrial output.

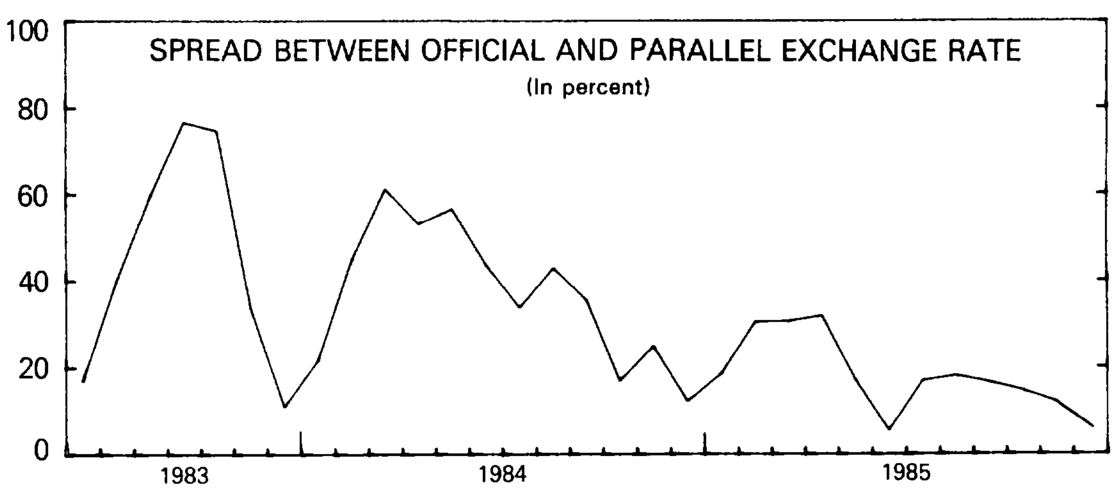
[2] Based on help wanted notices in the daily press.

CHART 6

ARGENTINA

EXCHANGE RATE DEVELOPMENTS





Sources. Central Bank of Argentina; and Fund staff estimates.

[1] Index is trade weighted and includes nominal exchange rates of major trading partners, deflated by consumer prices, increase means real appreciation.

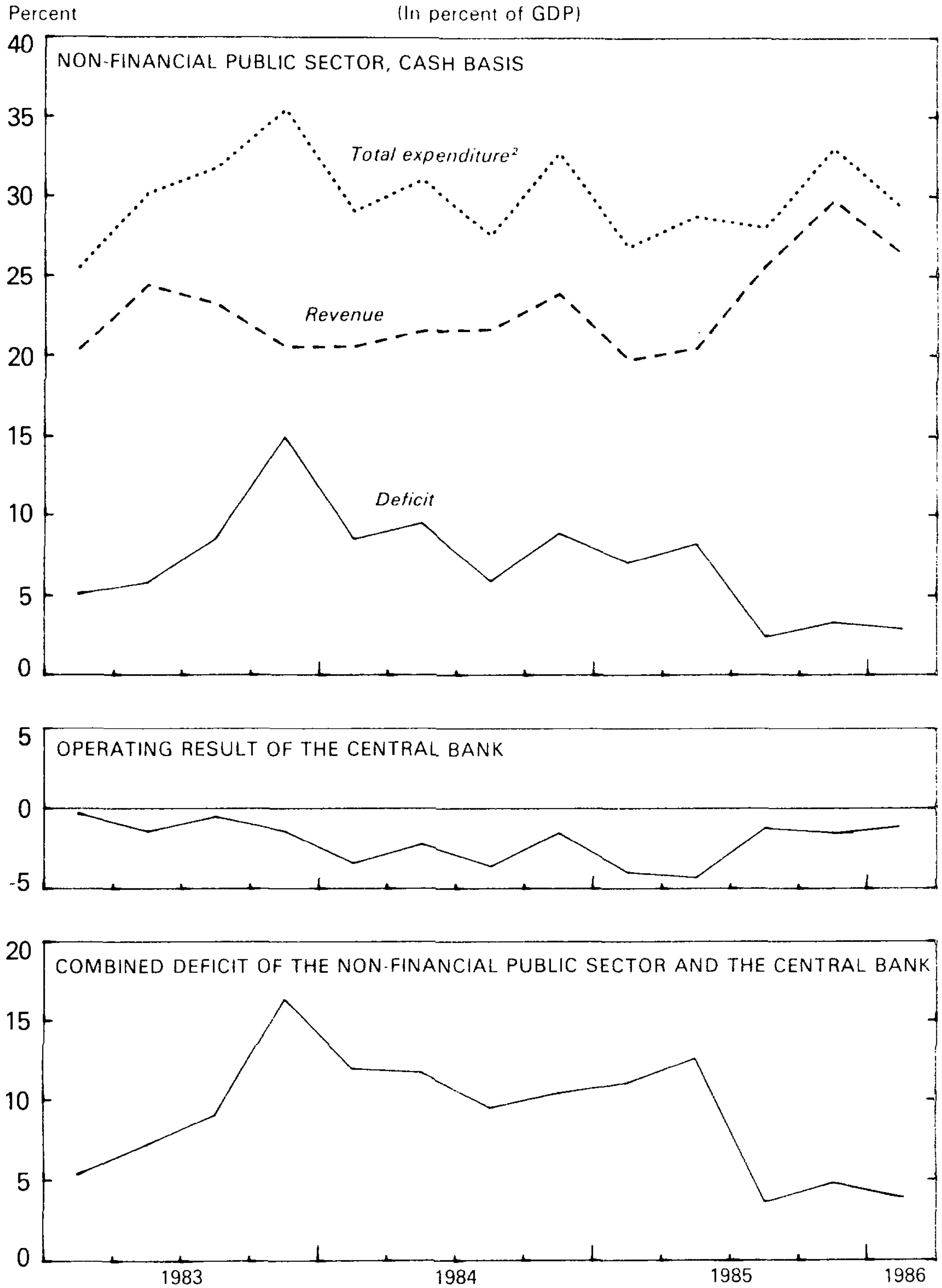
[2] Adjusted for the difference between the average change in the consumer price and national non agricultural price indices in Argentina and the change in the U.S. consumer price index; increase means real appreciation.

CHART 7

ARGENTINA

OPERATIONS OF THE PUBLIC SECTOR[1]

(In percent of GDP)



Sources: Ministry of Economy, and Central Bank of Argentina, and Fund staff estimates

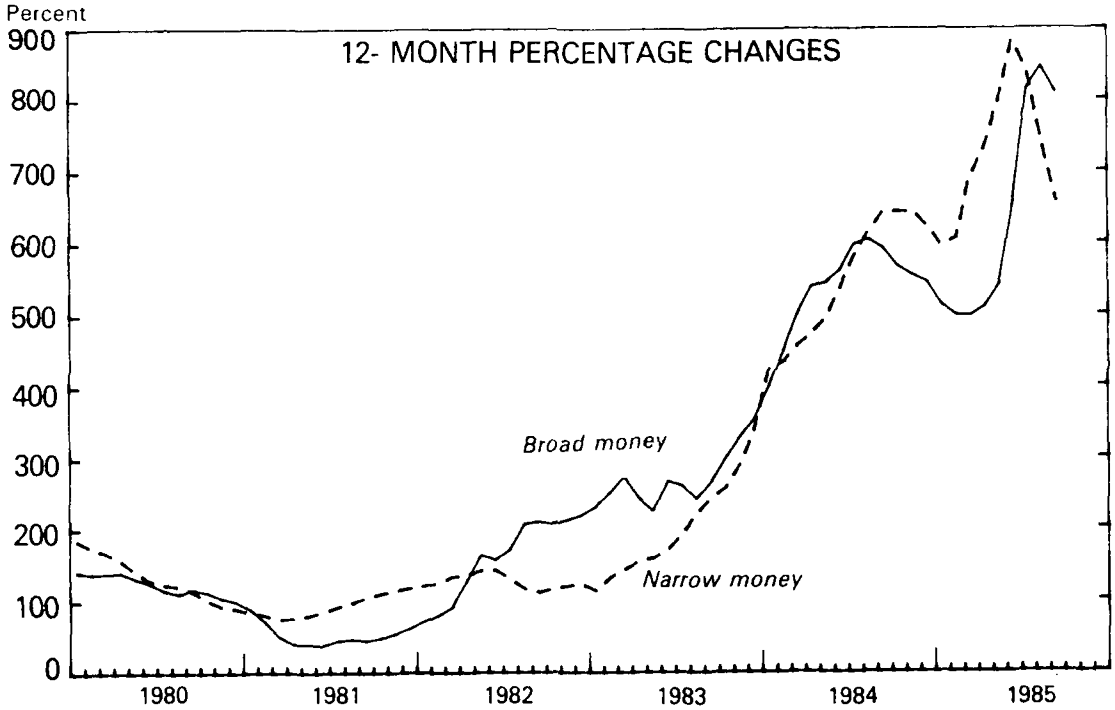
[1] Data shown are provisional actuals through the fourth quarter of 1985, and projections thereafter.

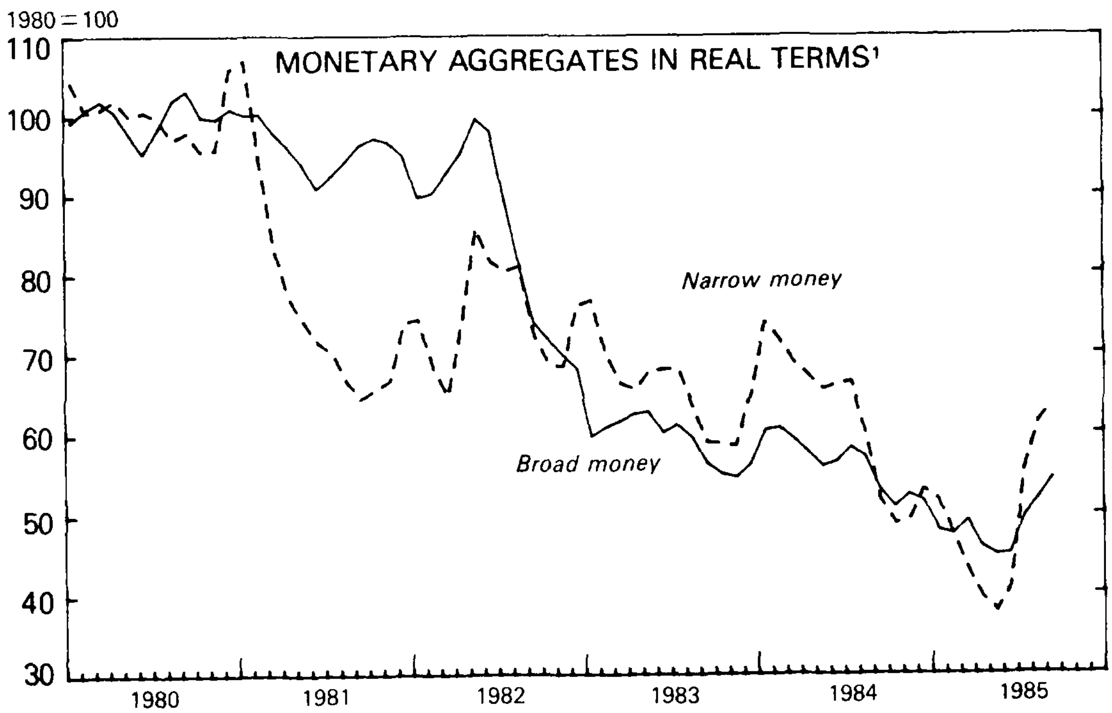
[2] Total expenditure of the general government plus the operating losses and capital expenditure of the public enterprises

CHART 8

ARGENTINA

MONETARY DEVELOPMENTS





Source: Central Bank of Argentina.

[1]Deflated by the consumer price index.

February 20, 1986

Dear Mr. de Larosière:

1. Some eight months ago, our Government initiated a frontal attack on inflation through a reduction of the fiscal deficit which included a commitment not to extend domestic financing to the public sector; a monetary reform and a tightening of monetary and credit policy; and a wage-price freeze, together with the pegging of the Argentine currency to the U.S. dollar. The results achieved have been positive. The rate of increase in consumer prices was reduced from a monthly average of 28 percent in the second quarter of 1985 to 2 1/2 percent a month from July 1985 to January 1986, while wholesale prices have risen at an average monthly rate of just over 1/2 percent since mid-1985. The sharp cutback of inflation has been accompanied by a recovery in output, after a sizable contraction in June-early July which reflected a large liquidation of inventories. The success of our program thus far has been helped by a change in price expectations based on a breaking of inertial inflation and the tackling of both the demand and cost factors in inflation. While there have been deviations in some areas of the program we described in our letters of June 11, 1985 and July 22, 1985 as part of the first review of the current stand-by arrangement, we are satisfied that the overall thrust of policy has been appropriate to achieve the objectives of the program. On this basis and on the strength of the policies set forth below, we request a waiver for the performance criteria that were not observed.

2. Our plan is to introduce structural measures in 1986 aimed at promoting economic growth while consolidating the stabilization effort and preserving a low rate of inflation. Our objective is to keep the rate of inflation, on average, to no more than 2 percent a month from December 1985 to December 1986, while achieving a continuing recovery of output. The details of our 1986 program have not yet been fully developed, but we are in a position to describe the policies and aims for the remaining period of the stand-by arrangement, which are consistent with the broad strategy for the full year.

3. The wage-price freeze helped reverse inflationary expectations by breaking wage-price indexation and has been an important component of the program. In the second half of 1985, the wage freeze was firmly applied in the public sector; in the private sector there occurred some increases in take home pay but in general firms were able to absorb them without serious implications for their financial position. The price controls were applied flexibly, and shortages were avoided.

4. The Government had said from the inception of the program that the wage-price freeze would be temporary, and towards the end of the year the Government convened the Economic and Social Conference--in

which both labor unions and entrepreneurial organizations participated--in order to set guidelines on incomes policy. No agreement was reached in the Conference, and the Government decreed a 5 percent general wage adjustment for both public and private sector employees, effective at the beginning of 1986; this increase is to incorporate any pay adjustment granted during the period of the freeze, and private firms have indicated that they can absorb it without raising prices. At the beginning of 1986 there also was a 50 percent adjustment in family allowances, representing a 2 1/2 percent average increase in take-home pay for private sector employees; however, this increase will have no effect on the costs of enterprises because it is to be paid out of the surplus of the family allowance funds without any increase in contribution rates. In addition, firms are permitted to raise wages by an additional 5 percent in the course of 1986 provided that such increase can be justified in terms of productivity gains and is not passed on to prices.

5. The Government intends to move gradually to remove price controls through agreements at the sectoral level which would establish undertakings on the part of businesses as regards their price behavior. It is expected that small firms, particularly in sectors in which there is a substantial degree of competition, will be freed more rapidly from controls in this process, whereas large firms for the time being would continue to be subject to cost-reporting requirements and would have to justify price increases on the basis of cost developments consistent with government guidelines. The intention of the Government remains to move as soon as possible to a situation in which prices are determined in the market.

6. Another key element of the program was a major strengthening of the public finances. It is now estimated that the combined public sector deficit--the cash deficit of the nonfinancial public sector plus the losses of the Central Bank--was reduced from 12.7 percent of GDP in the first half of 1985 to 4.2 percent of GDP in the second half. However, the deficit in the second half of 1985 exceeded the amount programmed. In the third quarter there was a revenue shortfall associated with delays in the passage of legislation establishing the compulsory savings plan, which was an important revenue-enhancing measure of the program. This legislation was eventually enacted, and for the third and fourth quarters taken together revenue was larger than had been projected. The source of the deviation in the fiscal program in the second half of 1985 was, therefore, a higher-than-projected level of expenditure, largely reflecting estimation errors and difficulties in establishing effective control on the operations of certain public enterprises. The only major policy decision taken in the second half of 1985 that had the effect of raising public expenditure was a 14 percent increase in social security benefits announced in October, with an estimated effect equivalent to 3/4 percent of GDP. In addition to the developments just described, there was a continuing substantial financial problem in the State Oil Company, which in large part took the form of increases in debt to contractors and suppliers.

7. For 1986, the objective of the Government is to keep the combined public sector deficit to no more than 3 percent of GDP, which in our view would be consistent with the commitment to avoid any domestic financing of the public sector. Approximately one third of the combined deficit would be accounted for by the losses of the Central Bank and two thirds by the cash deficit of the nonfinancial public sector. Keeping the losses of the Central Bank to around 1 percent of GDP in 1986 will require a major effort to bring rediscount rates closer to market rates of interest; since the beginning of 1986 the Central Bank has raised by 1 percentage point the monthly interest rate on the rediscount line related to the July 1982 refinancing of domestic private sector debt, and other measures will be adopted in the next few months. With respect to the nonfinancial public sector, the budget proposal for 1986 that was sent to the National Congress in the first week of February provides for a budgetary deficit (on a commitment basis) of 2.9 percent of GDP; we are aware that effective tax administration, strict expenditure control procedures, and careful management of the public enterprises will be needed to bring the cash deficit down to the targeted level of 2 percent of GDP. The priority given by the Government to improve budgetary control of the public enterprises has been reflected in the recent creation of a new office headed by a Secretary of State directly responsible to the President of the Republic. In particular, the Government is making a major effort to strengthen the finances and to improve the efficiency of the State Oil Company.

8. According to the budget recently presented to Congress, spending commitments of the nonfinancial public sector will fall by 1 1/2 percent of GDP in 1986, the third consecutive year in which commitments would have declined. However, there would be no progress this year in reducing the ratio of public sector cash spending to GDP, following a reduction from 33 percent of GDP in 1983 to 30 1/4 percent of GDP in 1985. Further reductions in this ratio may be expected in coming years as a result of a reduction of commitments in the 1986 budget as well as structural measures that the Government will begin to implement in the course of this year.

9. Despite the effort that is being planned to strengthen the public finances, which will result in a combined public sector deficit of no more than 3 percent of GDP in 1986 as a whole, it is not feasible to reduce the deficit in the current quarter below 4 percent of GDP. Accordingly, a limit of ₳ 593 million has been set for the combined deficit of the nonfinancial public sector and the Central Bank in the first quarter of 1986, with a sublimit of ₳ 443 million for the cash deficit of the nonfinancial public sector. With a view to maintaining the effort to restrain spending, a limit of ₳ 1,812 million also has been set for Treasury outlays for this quarter. These limits are presented in Table 1.

10. In the second half of 1985, monetary policy was broadly consistent with the intention we had expressed in our letter of July 22, 1985 that the Central Bank essentially would not extend credit on a net

basis. Nevertheless, monetary growth was rapid, as there was a substantial overperformance in respect of the target for the Bank's net international reserves. It is our view that the increase in the monetary aggregates reflected increased demand for real cash balances, and thus was not inconsistent with the objective of reasonable price stability. Nevertheless, and in line with a probable slowdown in the rate of growth of money demand, in recent months the monetary authorities have sought to curb Central Bank credit.

11. Other developments in the credit area in the second half of 1985 also gave us cause for concern, namely, a significant increase in rediscounts--mostly under existing lines to cover withdrawals of indexed deposits and to prefinance exports--and the incurrence of substantial reserve deficiencies by certain official banks. The Central Bank was able to offset the overall monetary impact of these developments by increasing reserve requirements on deposits, but this measure ran counter to the longer term objective of reducing the Central Bank's role as a financial intermediary. Therefore, beginning in November 1985 the Central Bank took measures to restrict the growth of rediscounts. Also, several weeks earlier the Central Bank had acted to improve the banks' compliance with reserve requirements by raising the cost of incurring reserve deficiencies.

12. For the period ahead, we believe that it remains of the utmost importance to maintain a cautious monetary policy stance to furnish reasonable assurances that the rate of inflation will be brought down in line with the objectives that have been set by the Government. Thus, monetary policy will continue to be guided by the principle that the Central Bank will not finance the public sector, except for the counterpart of funds borrowed abroad, and essentially will continue with the policy of not extending credit to the rest of the economy on a net basis. Consistent with this basic principle, the monetary program that has been prepared for the first quarter of 1986 includes a limit on the increase in the net domestic assets of the Central Bank (defined as the Bank's monetary liabilities minus net international reserves) of ₳ 1,042 million (Table 2). This limit allows for the seasonal pattern of broad money and the change in net international reserves that is programmed for the period.

13. In order to increase the flexibility of the financial system and to help improve its ability to compete with noninstitutionalized financial intermediaries, the Central Bank will seek to reduce the banks' reserve and investment requirements. To make possible such a reduction in the context of the overall monetary policy, the Bank will be restrictive in the granting of new rediscounts; at the same time, the Bank will act to encourage an acceleration in the repayment of credits granted to financial intermediaries, inter alia by the narrowing of the gap between the cost of rediscount lines and market interest rates mentioned above. Moreover, the Central Bank will strictly enforce the banks' reserve requirements. These measures constitute a first, important step in the process of strengthening the financial system; further

steps will be taken in order to reduce intermediation costs and increase the overall efficiency of the system.

14. In the second half of 1985 the deposit interest rate in the free segment of the financial system was on average 2.3 percentage points a month above the rate of increase in consumer prices, and the spread was higher in the case of lending rates. The Government believes that a lasting reduction of interest rates will be the result of the combined effect of the consolidation of the fiscal position, the improvement in the efficiency of financial intermediation, and the continuing abatement of inflationary expectations. The Central Bank will continue to reduce obstacles to the expansion of the segment of the financial market that is not subject to interest rate limits. As regards the regulated segment, whose share in total interest bearing deposits (excluding indexed deposits) declined from 76 percent in June 1985 to 46 percent in December, the setting of the interest rate will continue to be guided by the principles established in paragraph 27 of our letter of June 11, 1985.

15. The overall balance of payments deficit in 1985 was about US$1 billion smaller than had been programmed in mid-year, reflecting a better-than-projected performance in both the current and the capital accounts. The 1986 outlook is for a worsening in the current account in reflection of a decline in agricultural export prices and the damage to crops inflicted by extensive flooding in the Province of Buenos Aires in November 1985. On the other hand, implementation of the credit policy described above is expected to result in a continuation of the capital inflows that began with the adoption of our economic program in June 1985. On the basis of recent trends and the considerations just mentioned, a target for the net official international reserves has been established for the first quarter of 1986, which allows for a decline of up to US$878 million (Table 3).

16. We believe that the above balance of payments outcome is consistent with the financial policies described above and the present real effective value of the austral. Although Argentina's inflation since the pegging of the exchange rate in mid-June 1985 has exceeded that in industrial countries, the real effective exchange rate of the austral (in terms of a basket of currencies) has changed little, as the austral has depreciated together with the U.S. dollar against other major currencies. The adequacy of the exchange rate will be kept under scrutiny, with a view to ensuring achievement of the balance of payments objectives of the program.

17. Notwithstanding the overperformance in the balance of payments and the build-up of gross reserves after mid-1985, the limits on external payments arrears that had been established for end-September and end-December 1985 were exceeded by significant margins, reflecting in part administrative bottlenecks in the clearing of arrears. We consider reliance on arrears an undesirable method of financing, and we therefore would wish to have a payments system free of arrears as soon as

possible. However, given the present estimate of the external cash flow, we do not foresee that it will be possible to eliminate all external arrears by end-March 1986, as had been expected in the first review of the program. Accordingly, we intend to lower external payments arrears to no more than US$1,050 million by March 31, 1986, and to eliminate by that date any remaining private sector arrears (with the exception of some obligations for which we intend to negotiate a rescheduling); all external payments arrears would be paid by the end of June 1986 (Table 4).

18. Largely because of administrative bottlenecks, the Central Bank did not take the required steps to allow all private sector interest payments abroad on financial debt to be made automatically as of the end of October 1985, as had been provided for in the first review of the program. However, the Central Bank recently has issued regulations providing for the automatic provision of foreign exchange for the payment abroad of private interest obligations. Furthermore, it is our intention to eliminate all restrictions on payments and transfers related to services other than tourism by May 15, 1986.

19. In July 1985 the Government increased the proportion of imports in the base period (July 1981 to June 1982) in the automatic list to 63 percent. Because of administrative delays, it was not possible to implement the further increase to 68 percent by end-September 1985, as had been established in the first review of the program. However, this ratio was raised to 73 percent in January 1986, by transferring to the automatic list all electronic goods, including computers and parts thereof. At the same time, the import duties applicable to such goods were raised from a maximum of 38 percent to a maximum of 90 percent; these duty rates are to be lowered in steps in the next few years, and by October 1990 the maximum rate would be 50 percent. As regards other goods which are not yet in the automatic import list, the Government intends to transfer them to the automatic list--except for a limited list of luxury goods--as soon as possible. The work of the special commission which is studying the tariff schedule with a view to making necessary corrections has experienced delays, and it will not prove possible to implement the liberalization of the import regime by the end of March 1986, as had been provided for in the first review of the program. However, such liberalization will take place by May 15, 1986. While duty rates might be increased for some products which are transferred to the automatic list, it is the Government's intention to limit such increases so as to ensure that the goal of import liberalization is achieved and not to raise duty rates for goods already in the automatic list except to correct anomalies in the tariff schedule.

20. The Government recently reduced the export taxes on wheat, linseed, sunflower seed, wool, and other products, and a review is being conducted with a view toward reducing other export taxes to ensure adequate returns to traditional exports. Because of the fiscal constraint, the 10 percent temporary import surcharge which was imposed in June 1985 has been extended to the end of March, and a further extension

may be necessary, but it is the Government's intention to eliminate it altogether during 1986.

21. In 1985 the Government was successful in its efforts to secure needed exceptional finance from official and private creditors, as agreements were entered into with the Paris Club and commercial banks. We expect to continue these efforts, and we will be approaching Argentina's foreign creditors without delay to ensure that the balance of payments gap in 1986 is appropriately financed. Consistent with the balance of payments outcome in 1985 and prospects for coming months, the limits for the total and the short-term debt of the public sector that had been established in September 1984 will continue to guide our policy in this area through the end of the stand-by arrangement.

22. The Government believes that the policies and measures set forth above will enable it to achieve the objectives of the program but will adopt any further measures that may be needed for this purpose. On the basis of our economic program for 1986 which is now being finalized, it is our intention to request, at the expiration of the current stand-by arrangement, a new arrangement in support of our policies. We understand that the amount referred to in paragraph 1 of the stand-by arrangement of December 28, 1984 will be amended to SDR 1,182.5 million. To allow for a better transition to the new arrangement, we request that the expiration date of the current arrangement be extended from March 27, 1986 to May 31, 1986.

Yours sincerely,

J. J. Alfredo Concepción
President, Central Bank of Argentina

Juan Vital Sourrouille
Minister of Economy

Table 1. Argentina: Limits on the Cash Deficit of the Nonfinancial Public Sector, the Combined Deficit of the Nonfinancial Public Sector and the Central Bank, and Treasury Outlays

(In millions of australes)

	Cash Deficit of the Nonfinanical Public Sector 1/	Combined Deficit of Non-financial Public Sector and the Central Bank 1/	Treasury Outlays 2/
January-March 1986	443	593	1,812

1/ For purposes of measuring the cash deficit of the nonfinancial public sector, changes in the deposits of the nonfinancial public sector in the National Mortgage Bank will not be included to the extent that there are transfers in the first quarter from the Family Allowance Funds to the Social Security System.

2/ The limit on treasury outlays excludes interest payments by the Treasury and treasury transfers to other parts of the nonfinancial public sector for the payment of interest; the limit provides for transfers of ₳ 43 million to companies not included in the nonfinancial public sector for the payment of external interest and the limit will be reduced to the extent that these interest payments are not made. The limit includes payments of government guarantees net of recoveries; in setting the limit, a level of recoveries of ₳ 32 million has been assumed and the spending limit will be reduced to the extent that actual recoveries exceed ₳ 32 million.

Table 2. Argentina: Target for Change Since December 1985 in the Net Domestic Assets of the Central Bank 1/

(In millions of australes)

March 1986	1,042

1/ Net domestic assets of the Central Bank are defined as monetary liabilities of the Central Bank minus net international reserves of the monetary authorities (as defined in Table 3) valued at the exchange rate of ₳0.800 per U.S. dollar. For purposes of this measure, the monetary liabilities of the Central Bank are defined as each month's average broad money (currency in circulation plus all local currency-denominated deposits in the consolidated financial system not including accrued interest, plus central bank paper held by the nonfinancial private sector) times a factor of 0.445. This factor corresponds to the estimated average value in June 1985 of the ratio of the Central Bank's monetary liabilities (currency issue plus deposits of financial intermediaries in the Central Bank plus central bank paper held by the nonfinancial private sector) to broad money. Net international reserves for each month are the average of the estimate on the last day of the previous month and the four weekly estimates each month of net reserves (excluding arrears) minus the average level of arrears for the month. The target has been set on the basis of estimated monetary liabilities for December 1985 and will be adjusted to allow for the difference between the preliminary and the definitive estimates of monetary liabilities, once the definitive estimate is available.

Table 3. Argentina: Target for the Change in Net International Reserves of the Monetary Authorities 1/

(In millions of U.S. dollars)

1986	
January-March	-878

1/ The net international reserves of the monetary authorities are defined to include as liabilities the foreign currency deposits placed with the Central Bank by local financial intermediaries in connection with the system of foreign currency deposits adopted in July 1985, and to include as assets that part of these deposits held by the Central Bank in foreign currency or in liquid assets in banks abroad; thus central bank foreign currency rediscounts out of these deposits are not treated as international reserves, consistent with the treatment of other foreign currency credits granted by the Central Bank. Also, refinancing of public sector external payments arrears will be considered as a reserve liability. For measuring balance of payments performance, international reserve assets and liabilities in currencies other than the U.S. dollar will be converted to U.S. dollars at the market exchange rates of December 31, 1985 and gold will be valued at US$325 per fine troy ounce. The net international reserve targets will be adjusted for any other changes in the value of reserve assets and liabilities that result from factors other than balance of payments flows.

Table 4. Argentina: Limit on Outstanding External Payments Arrears 1/

(In millions of U.S. dollars, end of period)

September 1985	2,435
December 1985	1,640
March 1986	1,050 2/

1/ For purposes of this limit, external payments arrears are defined to exclude: (a) principal amounts due in the first quarter of 1986 subject to a 90-day rollover by foreign bank creditors; (b) certificates of deposits placed with the Central Bank in conformity with circulars A-404, A-562, A-576, A-696, and A-697; (c) principal and interest due to official creditors in the first quarter of 1986 subject to rescheduling under a possible new agreement with the Paris Club; and (d) principal due to nonbank, nonofficial creditors in the first quarter of 1986 for the same categories of loans that were rescheduled in 1985. The data for September 1985 are included for purposes of defining the series, and the figure for December 1985 is a preliminary estimate.

2/ The limit for end-March 1986 will be adjusted downward to the extent that arrears related to COGASCO are refinanced and arrears to foreign branches of Argentine banks are less than their level at the end of 1985.