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SM/80/173
Correction 1

CONTAINS CONFIDENTIAL
INFORMATION

July 28, 1980

To: Members of the Executive Board
From: The Secretary
Subject: Argentina - Staff Report for the 1980 Article IV Consultation

The following corrections have been made in SM/80/173 (7/16/80):

Page 2, para. 3, lines 10 and 11: for "domestic prices of petroleum prices lagged" read "domestic prices of petroleum lagged"

Page 9, 4th full para., lines 1 and 2: for "to curb inflation run the risk" read "to curb inflation runs the risk"

Page 10, 1st full para., penultimate line: for "which pressures on resources can" read "which pressures on reserves can"

Page 12, line 3: for "Population (mid-1978)" read "Population (mid-1979)"

line 6: for "Origin of GDP (1978)" read "Origin of GDP (1979)"

Page 13, last line: for "Central Bank an asury (net)" read "Central Bank and Treasury (net)"

Corrected pages are attached.

Att: (5)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

ARGENTINA

Staff Report for the 1980 Article IV Consultation

Prepared by the Staff Representatives for the
1980 Consultation with Argentina

Approved by E. Walter Robichek and C. David Finch

July 16, 1980

The 1980 Article IV consultation discussions with Argentina took place in Buenos Aires during the period May 19-30, 1980.^{1/} The Argentine representatives in these discussions included the Secretaries of Economy, Finance, Commerce and Foreign Trade, Agriculture, and Energy; the President of the Central Bank; and other officials and representatives of the Government and the Central Bank. The staff representatives were Messrs. Caiola (Head-WHD), Baban (ETR), Braz (WHD), Puentes (WHD), van Beek (WHD), and Miss French-Mullen (Secretary, WHD). Mr. Garces, Executive Director for Argentina, participated in the final round of discussions.

I. Background

Argentina's stabilization efforts in recent years have been supported by two successive stand-by arrangements with the Fund, the last of which expired on September 15, 1978. Argentina made no use of Fund resources under this last arrangement; instead, because of the strong rise in foreign reserves, by August 1978 Argentina had repurchased in advance all outstanding purchases made under previous stand-by arrangements, the compensatory financing facility, and the 1975 oil facility. Argentina presently has a net creditor position in the General Resources Account.

Since mid-1976 Argentina has been implementing a comprehensive program aimed at strengthening the balance of payments, reducing inflation, and setting the stage for a high and sustained rate of economic growth. To achieve these objectives the authorities have reduced the Treasury deficit in relation to GDP, pursued a flexible exchange rate policy, liberalized the exchange system, freed domestic prices, and reformed and liberalized the domestic financial system. Also, certain structural reforms, particularly in the agricultural sector, were implemented. Finally, Argentina has been following an energy policy that is expected to lead to self-sufficiency within the next few years. The authorities' program has been successful in improving the balance of payments situation and, on average, economic growth, but progress toward the objective of reducing inflation has been slow to come.

^{1/} Argentina has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement.

Over the 18 months ended in December 1978 the rate of inflation remained at about 170 per cent a year, and in 1979 the authorities modified their anti-inflation strategy. The economic program for 1979 (described in more detail below) was built around announced schedules for monthly adjustments of the exchange rate, minimum wages, and public sector prices that were designed to be consistent with a substantial slowdown in the rate of inflation. During the first three quarters of 1979 the inflation rate in Argentina remained almost unchanged, but it started to decline in the last quarter of the year. This trend has continued thus far in 1980, and in the eight months ended May 1980 consumer prices rose at an annual rate of about 90 per cent and wholesale prices at an annual rate of 51 per cent.

With regard to the behavior of demand and output, real GDP grew by 8-1/2 per cent in 1979 compared with a drop in the previous year. The rise in economic activity was particularly pronounced in manufacturing and in services, although gains above trend rates were registered by almost all sectors. Domestic demand was strong, reflecting in part the substantial inflow of funds from abroad. The unemployment rate continued at a low level.

The fiscal performance of the Treasury in 1979 was in line with the budget plan; the Treasury deficit in 1979 was equivalent to about 1-1/2 per cent of GDP, compared with 2 per cent in the previous year. The reduction in the deficit in 1979 reflected mostly a lower real level of expenditure. Treasury expenditures declined from the equivalent of 8-1/2 per cent of GDP in 1978 to about 8 per cent in 1979. Revenues remained at 6-1/2 per cent of GDP, as increases in the real value of receipts from indirect and import taxes roughly offset the drop in the real value of income tax collections (which are not on a pay-as-you-go basis) and the drastic reduction in collections from the fuel tax. The drop in revenue from the fuel tax reflected the fact that domestic prices of petroleum lagged behind inflation and international prices. Oil companies were allowed to retain a larger share of receipts from domestic sales to cover higher costs.

According to preliminary data, the overall deficit of the public sector as a whole fell from the equivalent of 6 per cent of GDP in 1978 to about 5 per cent in 1979. Little progress was made in reducing the level of expenditures in relation to GDP; in 1979 the ratio was about 37 per cent, which was lower than in 1978 but considerably higher than in 1976-77.^{1/} Notwithstanding a further reduction in public employment, wage and salary payments rose from 29 per cent of total public expenditures in 1978 to 32 per cent in 1979. Total revenues declined from about 34 per cent of GDP in 1978 to about 32 per cent in 1979.

During 1979 banks' liabilities to the private sector and credit expanded substantially faster than the rate of inflation, mainly in reflection of substantial foreign borrowing induced by the high interest rates prevailing in the domestic market compared with foreign rates adjusted for the rate of depreciation of the peso. In an effort to lower interest rates in general, the Central Bank reduced minimum legal reserve requirements during the second half of the

^{1/} Data on public sector operations are preliminary and subject to a margin of error. In the case of state enterprises, the information available for 1978-79 refers to budget rather than actual data; this is also the case with rest of public sector operations for 1979.

yearly growth rate of demand in the interim period). The plan relies heavily on the construction of hydroelectric plants and, to a limited extent, on nuclear plants.^{1/} It is envisaged that by 1995 some 73 per cent of electricity generation will be from hydroelectric sources (compared with 36 per cent in 1980), 15 per cent from nuclear sources (6 per cent in 1980), and 12 per cent from thermal sources (58 per cent in 1980). Even with this much lower share of electricity from thermal sources, more oil will be required than is available at present in view of the growth in total demand that is projected. Coal production is expected to be maintained at approximately current levels, given the high cost of expanding output in that sector.

During 1979, domestic prices of petroleum products were not adjusted to reflect the full impact of increases in world prices for oil and for domestic costs of production and marketing. In fact, it is estimated that they declined by some 15 per cent in real terms. During 1980, the authorities intend to increase domestic prices so as to correct this deviation.

III. Staff Appraisal

Since the end of 1978 Argentina has been implementing an economic program aimed at achieving a substantial reduction in the rate of domestic inflation. For this purpose the authorities have been opening the economy to foreign competition through a reduction of import duties, and they have been depreciating the peso according to a preannounced schedule that was consistent with a marked slowing of the rate of price increase.

During the first nine months of 1979 little progress was made in reducing inflation, but subsequently the program showed distinct signs of success. Inflation, as measured by the rise of consumer prices, declined to an annual rate of 90 per cent during the eight months ended May 1980, compared with 166 per cent during the previous eight-month period. The rate of increase of the wholesale price index has come down even more sharply, from 175 per cent to 51 per cent. In general, inflation in Argentina appears to have been lowered to a pace consistent with the rates of external inflation and the depreciation of the peso.

Maintenance of the present economic policies that are designed to curb inflation runs the risk of inducing a significant degree of sluggishness in economic activity in the period ahead, a possibility of which the authorities are very much aware. However, they have made it clear that the slowing of domestic inflation has the highest priority since it is a precondition to the achievement and maintenance of a high rate of economic growth. The staff welcomes the determination of the authorities to see their program through to a successful conclusion.

The opening of the economy to greater foreign competition has as its objective not only a reduction of inflation, but also the achievement of a better allocation of resources. Therefore, it is important that the authorities press ahead with the liberalization of the import tariff regime. The staff would note that the

^{1/} Argentina currently has one nuclear plant in operation. A second plant is under construction, and there are plans for a third.

faster that import tariffs are reduced, the smaller is the risk that resources will be shifted out of export activities and into the production of nontradables and services.

With regard to the financial policies underpinning the anti-inflation effort, it should be noted that while the deficit of the public sector has been reduced substantially, its claims on available resources continue to be substantial; also, total public spending has been increasing in relation to GDP in recent years. The more that is done to strengthen the fiscal position, the smaller will be the pressures on the resources available to the private sector (particularly for investment) and on the credit policy of the Central Bank, and therefore, the greater the chances that the effort to lower inflation will be kept on course. In the setting of Argentina, fiscal policy is, after all, the most effective instrument for regulating aggregate demand. Successful implementation of the authorities' strategy requires that the credit policy of the Central Bank be geared to protecting the foreign reserve position, to the extent needed to avoid any question that the exchange rate strategy be carried through as planned. Argentina has a high level of international reserves, but recent experience demonstrates the volatility of expectations about the exchange rate and the suddenness with which pressures on reserves can develop. The prompt and decisive response of the authorities to the recent financial crisis was encouraging.

Although the current account of the balance of payments has shifted from surplus to deficit, Argentina's external position is still reasonably strong. As was just mentioned its international reserves are still comfortable, and it has a favorable standing in international money and capital markets. Although data that became available recently indicate that Argentina's external debt at the end of 1979 was considerably higher than had been suggested by earlier estimates, the debt situation is not one that is worrisome at this time, but developments in this area should be monitored carefully since the likelihood is that the current account deficit will continue to grow for a time.

Fund Relations with Argentina

Status: Article VIII.

Quota: Present: SDR 535 million.
Proposed (Seventh Review): SDR 802.5 million.
Argentina has already consented to the increase in its quota.

Fund holdings of Argentine pesos:	<u>As of June 30 ,1980</u>	<u>Millions of SDRs</u>	<u>Per Cent of Quota</u>
Total currency holdings		340.07	63.6
Holdings from outstanding purchases		None	None

Special Drawing Account:	Cumulative SDR allocation	SDR 263.8 million
(As of June 30, 1980)	Net acquisition of SDRs	SDR 58.4 million
	Holdings of SDRs	122.1 per cent of allocation

Gold distribution: Argentina has received four distributions totaling 376,565 fine ounces of gold.

Distribution of profits
from gold sales: US\$41.15 million.

Transactions with the Fund: Argentina has been granted nine stand-by arrangements, the last of which expired on September 15, 1978. Argentina made no purchase thereunder.

Exchange rate: On June 30, 1980 the exchange rate in terms of \$a per U.S. dollar was \$a 1,851 buying and \$a 1,858 selling.

Argentina--Basic Data

Area and population

Area (continental)	2,792,000 sq. kilometers
Population (mid-1979)	26.8 million
Annual rate of population increase (1975-79)	1.4 per cent

GNP per capita (1979 est.)

SDR 3,126

Origin of GDP (1979)

(per cent)

Agriculture	12.2
Manufacturing	35.3
Construction	5.7
Transport and communications	7.1
Commerce	17.3
Other	22.4

Ratios to GDP (1979)

Exports of goods and services	9.4
Imports of goods and services	9.9
Central government revenues	6.6
Central government expenditures	8.2
External public debt (end of year)	9.1
Saving	29.4
Investment	29.9
Money and quasi-money (end of year)	36.0

Annual changes in selected economic indicators

	<u>1977</u>	<u>1978</u>	<u>1979</u>
		(per cent)	
Real GDP per capita	3.8	-5.3	7.0
Real GDP	4.9	-3.4	8.5
GDP at current prices	159.1	147.8	175.0
Domestic expenditures (at current prices)	154.9	147.3	184.7
Investment	171.3	125.2	186.6
Consumption	147.6	158.0	183.8
GDP deflator	146.9	156.6	153.5
Wholesale prices (annual averages)	149.4	144.9	149.3
Cost of living (annual averages)	173.6	175.5	159.5
Central government revenues	228.9	161.9	184.6
Central government expenditures	100.6	132.8	166.3
Money and quasi-money	253.5	188.5	187.8
Money	123.4	169.2	140.9
Quasi-money	405.2	198.5	209.7
Net domestic bank assets <u>1/</u>	241.0	188.6	211.2
Credit to public sector (net)	22.9	13.9	16.1
Credit to private sector	209.0	144.8	166.5
Merchandise exports (f.o.b., in U.S. dollars)	44.3	13.2	22.1
Merchandise imports (c.i.f., in U.S. dollars)	37.2	-7.9	74.2

<u>Treasury finances</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>
	<u>(billions of Argentine pesos)</u>		
Revenues	1,271.6	3,330.6	9,478.5
Expenditures	1,911.7	4,450.5	11,852.4
Overall deficit (-)	-640.1	-1,119.9	-2,373.9
External financing (net)	7.9	447.8	332.5
Internal financing (net)	633.0	672.1	2,041.4
<u>Balance of payments</u>	<u>(millions of SDRs)</u>		
Merchandise exports, f.o.b.	4,841	5,112	6,046
Merchandise imports, c.i.f.	3,565	-3,062	-5,170
Investment income (net)	-496	-544	-689
Other services and transfers (net)	325	-41	-544
Balance on current and transfer accounts	1,105	1,465	-357
Official capital (net)	-20	419	406
Financial sector (net)	312	448	1,732
Private capital (net) ^{2/}	500	260	1,657
Change in official net reserves (increase -)	-1,897	-2,592	-3,438
<u>International reserve position</u>	<u>May 31</u>	<u>Dec. 31</u>	<u>May 31</u>
	<u>1979</u>	<u>1979</u>	<u>1980</u>
	<u>(millions of SDRs)</u>		
Central Bank (gross)	5,573.4	7,342.0	6,469.3
Central Bank (net)	5,559.3	7,276.4	6,418.6
Central Bank and Treasury (net)	5,318.9	7,095.7	6,286.4

^{1/} In relation to the stock of money and quasi-money at the beginning of the period. Excludes contra-entry of SDR allocations.

^{2/} Includes valuation adjustments and errors and omissions.

