

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

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

- the staff report for the third review under the Stand-By Arrangement and request for waiver of nonobservance and applicability of performance criteria, prepared by a staff team of the IMF, following discussions that ended on **July 14, 2003**, with the officials of Argentina on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on July 17, 2003.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of **July 28, 2003** updating information on recent developments.
- a Press Release summarizing the views of the Executive Board as expressed during its **July 28, 2003** discussion of the staff report that completed the review.
- a statement by the Executive Director for Argentina.

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

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INTERNATIONAL MONETARY FUND

ARGENTINA

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

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

Approved by John Dodsworth and G. Russell Kincaid

July 17, 2003

- **Stand-By Arrangement.** An eight-month arrangement for SDR 2.17 billion (US\$2.9 billion, or 170 percent of quota on an annual basis) was approved by the Executive Board on January 24, 2003 (Table 1). Access was broadly equivalent to obligations (including charges) falling due during January 24–August 31, 2003. All repurchase expectations during the period of the arrangement (amounting to SDR 2.8 billion) were converted to an obligations basis. Cumulative purchases, so far, amount to SDR 1,199.4 million; completion of the third review would allow a purchase of SDR 748.9 million.
- **Discussions.** Discussions were held in Buenos Aires during July 3–14 with Economic Minister Lavagna, Cabinet Chief Fernandez, Central Bank President Prat-Gay, and other senior officials and private sector representatives. The staff team comprised J. Dodsworth (Head), J. Thornton, A. Cebotari, L. Giorgianni, J. Nemes (all WHD), A. Arvanitis (PDR), M. Petri (FAD), J. Roaf and C. Lim (both ICM) and R. Weeks-Brown (LEG). It was assisted by L. Cubeddu, the Fund resident representative. An MFD mission led by D. Hoelscher participated in the discussions. Mr. Zoccali (Alternate Executive Director) attended the policy meetings.
- **Program Developments.** The macroeconomic program remains on track and end-June quantitative performance criteria are expected to have been met (Table 2). In the structural areas, some progress is being made in regard to public bank restructuring, but there are delays in meeting some other benchmarks. Following congressional passage of a law on media companies, a waiver is requested for the nonobservance of the continuous structural performance criterion related to the involuntary suspension of creditor rights.
- **Letter of Intent.** In the attached LOI, the authorities describe recent policy developments and reiterate their intention to continue discussions toward early finalization of a successor arrangement.

| | Contents | Page |
|------------|--|------|
| I. | Recent Developments | 3 |
| II. | Report on Policy Discussions | 4 |
| | A. Macroeconomic Framework | 4 |
| | B. Financial Policies | 5 |
| | C. Structural Reforms | 5 |
| III. | Next Steps | 7 |
| IV. | Staff Appraisal | 7 |
| Boxes | | |
| 1. | Continuous and Structural Performance Criteria and Structural Benchmarks for the August 2003 Purchase | 9 |
| Tables | | |
| 1. | Revised Schedule of Purchases Under the Stand-By Arrangement, January–August 2003 | 10 |
| 2. | Quantitative Program Targets and Outcome, January–June 2003 | 11 |
| 3. | Net Debt Service to the IFIs, January–August 2003 | 12 |
| 4. | Federal Government Operations, 1999–2003 | 13 |
| 5. | Federal Government Tax Revenue, 2002–03 | 14 |
| 6. | Provincial Government Operations, 1998–2003 | 15 |
| 7. | Selected Economic and Financial Indicators, 1998–2003 | 16 |
| 8. | Summary Balance of Payments, 1998–2003 | 17 |
| 9. | External Financing Requirements and Sources, 2001–03 | 18 |
| 10. | Summary Operations of the Financial System, 1998–2003 | 19 |
| Figures | | |
| 1. | Confidence Indicators | 20 |
| 2. | Indicators of Real Activity | 21 |
| 3. | External Sector Developments | 22 |
| 4. | Recent Monetary Developments | 23 |
| Annexes | | |
| I. | Fund Relations | 24 |
| II. | Relations with the World Bank Group | 27 |
| II. | Relations with the Inter-American Development Bank | 30 |
| Attachment | | |
| I. | Letter of Intent | 32 |

I. RECENT DEVELOPMENTS

1. **The new government has been given a favorable reception.** Since end-May, President Kirchner's approval ratings have soared and market sentiment has further improved (Figure 1). In particular, there has been a marked rise in consumer confidence, the *peso* has appreciated, and interest rates have fallen further. Prices of defaulted Argentine bonds have risen reflecting, in part, the market perception that early agreement on a medium-term program with the Fund is now more likely.

2. **The economic recovery continues, but at a more moderate pace.** Real GDP grew by 5.4 percent in the year to the first quarter. Since then, however, industrial production has shown small declines in both April and May, and construction activity—an important factor earlier—appears to be leveling off (Figure 2). Reflecting the still large output gap and the *peso* appreciation, consumer prices have declined slightly during May and June. Inflation during the first half of 2003 was only about 2 percent. The authorities increased minimum wages by 50 percent (about 3 percent in real terms since the onset of the crisis) phased in over the remainder of the year; and increased the minimum pension by 10 percent. The minimum wage increase directly affects only about 5 percent of formal sector workers (3.9 million).¹

3. **The *peso* continues to be under upward pressure.** Despite a sharp rebound in imports, the external trade surplus is averaging about US\$1.4 billion per month (Figure 3). Export receipts in recent months have been seasonally high and the central bank has regularly entered the market to make net foreign exchange purchases. The resulting increase in gross international reserves, however, is quite modest (although substantially higher than originally programmed)—about US\$2.6 billion during the first half of the year. The situation reflects net private capital outflows and net debt service payments to the IFIs of about US\$1.6 billion during the first half of the year (Table 3).²

4. **The fiscal performance of the federal government continues to be significantly better than programmed.** The overperformance on the primary surplus through end-May was Arg\$882 million (0.2 percent of projected annual GDP), reflecting buoyant income tax collections and continued tight control over spending (Tables 4–6). Arrears on VAT refunds to exporters showed a small reduction of about Arg\$55 million in April–May. Partial data for June suggest that the federal primary surplus target has again been exceeded and VAT arrears

¹ The authorities estimated the impact of the minimum wage increase on the public finances not to be large given the relatively small number of public employees earning the minimum wage. In addition to the wage and pension increases, the authorities also incorporated decreed supplements paid by the private sector since last year into the basic wage.

² Following a disbursement by the IDB in early July of US\$0.8 billion the shortfall relative to program is about US\$0.4 billion, mainly reflecting lower-than-programmed disbursements from the World Bank, which are expected to be made up in August 2003.

to exporters further reduced. Provincial fiscal data (for April) confirm earlier trends that the provinces are adhering to bilateral agreements.

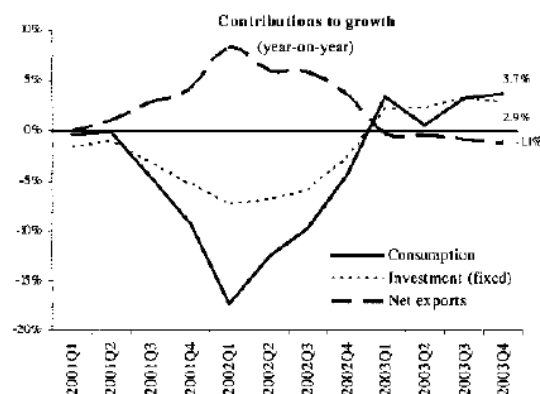
5. **Monetary policy has remained on track.** The latest data indicate that the end-June quantitative performance criteria for the BCRA's net international reserves and net domestic assets will be met with wide margins.³ As foreshadowed in the second review, base money growth has exceeded the indicative target, reflecting unsterilized accumulation of reserves. Interest rates on three-month central bank paper have fallen from 22 percent in March to about 8 percent recently.

6. **Intermediation through the banking system continues to be minimal.** Although private bank deposits have been growing, this is at a slower pace than base money. Moreover, with banks experiencing operating losses, and compensation for asymmetric indexation and *amparos* still delayed, private sector credit has yet to show any signs of recovery (Figure 4). The gradual unfreezing of restricted deposits has not given rise to significant pressures on the banks. The central bank has effectively reduced reserve requirements to ease banks' liquidity needs resulting from maturing frozen deposits. Meanwhile, the program for redemption of quasi-monies is progressing with roughly 30 percent of the end-March stock now removed from circulation.

II. REPORT ON POLICY DISCUSSIONS

A. Macroeconomic Framework

7. **The macroeconomic framework for 2003 has been revised in light of recent data.** Real GDP growth has been slightly raised to 4½–5 percent, consistent with the latest consensus forecast, while consumer price inflation is expected to be in the range of 5–8 percent by year-end depending on utility price adjustments still to be determined (Table 7). Domestic demand is projected to drive the recovery, underpinned by an ongoing improvement in real personal incomes, recovering confidence, and a rebound in investment from a low base. After having supported growth since the onset of the crisis, net exports are now projected to act as a drag on real growth, owing chiefly to a sharp recovery in imports (Tables 8–9). The authorities noted there was potential for output growth to be higher than projected.



³ The end-June monetary targets are computed on the basis of a centered 21-day moving average. Staff expects to be able to report on the end-June monetary data by the time of the Board meeting.

B. Financial Policies

8. **The authorities confirmed their intention to adhere to current macroeconomic policies for the remainder of 2003.** In the fiscal area, nominal revenue projections have been revised downward mainly on account of the new lower inflation assumption, although the revenue-to-GDP ratio is expected to be higher than programmed. The authorities plan to contain spending, so as to achieve the original consolidated primary surplus target of 2½ percent of GDP for the year as a whole. Staff pointed out that locking in the present overperformance on this target would be helpful given the need to raise the primary surplus significantly over the medium term. As regards monetary policy, the central bank intends to continue a relatively cautious monetary policy by targeting an increase in base money slightly above projected growth in nominal income in the second half of 2003 (Table 10).

9. **The authorities expressed some concerns over the volatility of short-term capital flows.** In July, they raised the minimum maturity requirement on foreign borrowing from 90 to 180 days and extended this requirement to the financial sector. Staff indicated that they saw little evidence that short-term capital inflows posed a problem at this stage, and that the measure was unlikely to provide greater room for maneuvering monetary policy. However, the authorities felt they needed to retain the possibility of a further tightening of controls on short-term capital inflows, in the event that volatility is seen as complicating monetary policy management.

C. Structural Reforms

10. **The remaining structural content of the transitional program is quite limited** (Box 1). There are three structural benchmarks associated with the third review. Progress has been made on each, but none of the measures has yet been finalized.

- **Draft legislation amending the Financial Institutions Law** has been approved by the Senate, but still awaits passage by the lower house.⁴
- **The specification of transitional capital requirements** for banks' exposure to the public sector and interest rate risk is scheduled to be considered by the central bank board on July 24 and the associated regulation is expected to be issued by end-July.
- **A memorandum of understanding on central bank profit transfers** is still under discussion between the Ministry of Economy and the central bank. The authorities indicated that this memorandum—which was recommended under the Safeguards Assessment—is expected to be signed during July.

⁴ As noted in the second review, although the latest draft of this legislation fails to provide the full protection to officials involved in the bank resolution process contemplated in the program, it provides the maximum protection allowed under the Constitution.

- **An agreement has been reached to launch the bidding process for due diligence and strategic review of *Banco Provincia*, the second largest public bank.** This long delayed measure—originally a structural benchmark for the first review—has been held up most recently by differences with its main shareholder, the province of Buenos Aires, over criteria to be used in the valuation of assets. The authorities have now indicated they will carry out due diligence of the loan portfolio on the basis of both existing central bank regulations (with forbearance) and of future regulations when temporary forbearance is removed. In regard to the third largest public bank, *Banco Ciudad*, the authorities have agreed to the need for its inclusion in the public bank restructuring program, but the bank has not agreed. Discussions with the bank management and owners (the city of Buenos Aires) are continuing.

11. **A law on the media sector that became effective in July has resulted in nonobservance of the continuous performance criterion on creditors' rights.** The law has two important provisions: (i) a limit on new foreign investment in media companies to a maximum of 30 percent of the equity and voting rights of such companies; and (ii) an exemption for Argentine-owned media companies from a provision in the insolvency law (the cramdown) that gives creditors and third parties the right to bid for control of a company undergoing court-supervised reorganization if the company's restructuring plan fails to secure adequate creditor support. The authorities strongly questioned whether the elimination of the cramdown provision affected creditors' rights as such and caused any nonobservance of the performance criterion. They pointed out that, in any case, the media sector represents a relatively small share of economic activity, and that this initiative was unlikely to affect the wider objectives of the program.⁵ In requesting a waiver of nonobservance of the related continuous structural performance criterion, the authorities committed to establish a working group, with agreed terms of reference, to review certain aspects of the insolvency framework, including the recent actions taken for the media sector.

12. **In regard to the previous nonobservance of the continuous performance criterion on creditor rights, the authorities are working toward termination of the temporary stay on mortgage foreclosures.** In late June, they issued a decree that: (i) establishes a mortgage registry to identify all debtors with pending mortgage foreclosures and all creditors who believe that their rights have been impaired by the stay; and (ii) indicates that alternative measures will be recommended to congress by early September to alleviate problems of poor debtors without impairing creditor rights or weakening the fiscal situation (LOI, ¶3). On this basis, they expect the measure will automatically lapse when the 90-day period expires.

13. **An important tax administration reform package aimed at improving tax compliance was announced in June.** The objectives are to: (i) increase the effectiveness of tax tribunals to facilitate the prosecution of tax evaders; (ii) toughen sanctions for tax

⁵ Consolidated debt of media sector firms represents about 2 percent of total nonbank private sector debt.

evasion; (iii) focus tax audits on higher-risk taxpayers; (iv) widen enforcement powers of the tax-collection agency; and (v) reforming the minimum presumptive income tax. Some of the key measures need congressional approval and draft legislation in these areas has been submitted. Staff were supportive of these initiatives, many of the measures having been recommended previously by FAD technical assistance missions.

III. NEXT STEPS

14. **The mission held very preliminary discussions on next steps toward a successor arrangement with the Fund and the normalization of relations with bilateral official and private creditors.** The authorities indicated that they wished to move quickly toward reaching understandings on a medium-term program that could be supported by the Fund, beginning with discussions that could start immediately following completion of the third review of the transitional program. At this stage, however, the new government is still at a relatively early stage in the process of formulating its economic policies, including on the key elements of the budget for 2004. A successor arrangement would necessarily involve exceptional access, and the exceptional access procedures (BUFF/03/28) would be followed.

15. **On debt restructuring, the authorities indicated that they hoped to present the outline of a restructuring offer by the time of the Annual Meetings in September,⁶** and reaffirmed their commitment to the equitable treatment of bondholders. In pursuit of these goals, the authorities invited the bondholders to form consultative groups to provide a forum for more focused discussions on debt restructuring proposals. Initial meetings with these groups are planned for the end of July 2003 in Europe, the United States, and Japan. Meanwhile, the authorities have yet to sign the deferral agreement with Paris Club creditors that postpones payments falling due through end-August 2003. They are working with the Paris Club to agree on the coverage of the agreement, including whether to incorporate provincial debt.

IV. STAFF APPRAISAL

16. **The responsible conduct of macroeconomic policies has continued with the new government.** These policies have been key to stabilizing the economic situation and improving growth prospects. They have also contributed to a gradual return of confidence, though the continuation of private capital outflows, at the same time as arrears to private creditors are being accumulated, shows that much remains to be done to entrench confidence and sustain growth.

17. **Maintaining budgetary control in the face of demands to stimulate the economy and step up social and infrastructure spending will be the immediate challenge.** Staff are encouraged by statements from President Kirchner and cabinet members that fiscal discipline

⁶ The authorities announced this timetable at recent meetings held with external creditors in Paris, London, Zurich, and Frankfurt.

will be the hallmark of the new government. The announcement of a tax administration reform package is an important step given Argentina's low tax ratio and poor record of tax compliance. However, there remains the need for substantial tax reform over the medium term, to underpin a higher primary fiscal surplus, and to replace distortionary taxes, such as those on the export sector and on financial transactions.

18. **The achievement of broad price stability attests to the adept handling of monetary policy in recent months.** While the authorities need to remain vigilant to any resurgence of inflationary pressures, staff supports the central bank's stance of cautiously expanding base money while accumulating international reserves. Underlying this picture, however, is a banking system that continues to be loss-making and short of capital. Advancing on a meaningful banking strategy, including the payment of compensation owed by the government to the banks, is urgent and will clearly be one of the critical elements of a successor arrangement.

19. **The unevenness of structural reform implementation remains the major concern of the staff, especially for the sustainability of the recovery.** In terms of the remaining structural conditionality for this review, staff urges the authorities to quickly progress in the hiring of financial advisors to conduct the strategic review of the two largest public banks, and make all efforts to ensure participation of *Banco Ciudad* in the process. Staff also urges the authorities to announce as soon as possible appropriate transitional capital requirements for banks' exposure to the public sector and interest rate risk, to finalize the memorandum of understanding on central bank profit transfers, and to expedite passage of amendments to the Financial Institutions Law.

20. **Staff regret the recent congressional initiative to favor media companies by exempting them from the cramdown provisions of the insolvency law.** While this action may, as the authorities claim, have limited impact, it will be viewed as another indication of the strength of vested interests. As with other recent instances where creditor's rights are curtailed, the provisions of the new media law will be damaging to Argentina's prospects for attracting financing and investment flows. Staff welcomes the authorities' assurance that such measures will not be extended to other sectors of the economy and look forward to the recommendations of the working group that will review aspects of the insolvency law.

21. **Sustaining the recovery will require the deepening and broadening of structural reforms and the normalization of Argentina's relations with external creditors.** Staff stand ready to work in full cooperation to help the authorities achieve their goals of moving rapidly to a medium-term successor arrangement and a collaborative agreement with private creditors. The timetable over the next two months is highly ambitious and will require decisive actions by the authorities to put in place a comprehensive and credible plan to address the complex and severe problems that Argentina continues to face.

22. **Staff supports the granting of requested waivers and completion of the third review, including of financing assurances.** The staff recommendation is based on continued good macroeconomic performance under the program, and the authorities' commitment to review the insolvency framework to ensure that it conforms to international best practice.

**Box 1. Continuous and Structural Performance Criteria and
Structural Benchmarks for the August 25, 2003 Purchase 1/**

I. Performance Criteria

Continuous performance criteria

- Nonaccumulation of arrears to bilateral and multilateral creditors.
- Nonissuance of quasi-monies by provincial governments that have signed the bilateral agreements.
- No statute or other legal instrument will be adopted that provides a means for any involuntary suspension of creditors' rights.
- Remaining competitiveness plans will not be extended beyond July 31, 2003, except for public transportation which will be terminated by end-December, 2003.

II. Structural Benchmarks

Continuous

- Provide Fund staff with monthly information on provincial government financing with a delay of less than 55 days.

July 25, 2003

- Agreement on a memorandum of understanding between the central bank and the government on the conditions for the transfer of realized central bank profits.

July 31, 2003

- Announcement of transitional capital requirements for exposure to the public sector and interest rate risk.

August 25, 2003

- Congressional approval of amendments to the financial institutions law.

1/ The August 25, 2003 purchase is also subject to a financing assurances review, which the staff proposes to be completed on a lapse-of-time basis.

Table 1. Argentina: Revised Schedule of Purchases Under the Stand-By Arrangement, January-August 2003 1/

| Date | Amount in Millions of SDRs | In Percent of Quota | Conditions |
|------------------------|-------------------------------|------------------------|--|
| January 24, 2003 | 747.0 | 35.3 | Disbursed on Board approval |
| March 20, 2003 | 226.2 | 10.7 | Disbursed on conclusion of the first review |
| June 20, 2003 | 226.2 | 10.7 | Disbursed on conclusion of the second review |
| July 25, 2003 2/ | 748.9 | 35.4 | Observance of end-June 2003 monetary performance criteria and completion of third review |
| August 25, 2003 3/ | 226.2 | 10.7 | Observance of end-June 2003 fiscal performance criteria and completion of financing assurances |
| Total access 4/ | 2,174.5 | 102.7 | |

1/ All purchases are subject to financing assurances reviews and adherence to continuous structural performance criteria.

2/ Originally scheduled for June 29, 2003.

3/ Originally scheduled for August 15, 2003.

4/ Total access on an annual basis is 170 percent of quota.

Table 2. Argentina: Quantitative Program Targets and Outcome, January-June 2003 1/
(In millions of pesos, unless otherwise indicated)

| | End-January | | End-March | | | End-May | | | PC |
|---|-----------------|---------|----------------------|----------|---------|----------------------|----------|---------|----------|
| | Adjusted Target | Actual | Performance Criteria | | Actual | Performance Criteria | | Actual | End-June |
| | | | Target | Adjusted | | Target | Adjusted | | |
| A. Fiscal Targets | | | | | | | | | |
| 1. Cumulative primary balance of the federal government (floor) | 424 | 855 | 1,500 | 1,500 | 1,794 | 3,310 | 3,310 | 4,192 | 4,500 |
| 2. Cumulative overall cash balance of the federal government 2/ | 18 | 498 | -2,307 | -2,307 | -197 | -2,708 | -2,708 | 1,084 | -2,198 |
| 3. Federal government debt stock (ceiling) | 451,815 | 450,586 | 576,000 | 422,673 | 420,509 | 603,000 | 438,549 | 436,883 | 612,000 |
| 4. Cumulative overall balance of the provincial governments 2/ | ... | ... | -350 | ... | 153 | ... | ... | ... | -712 |
| 5. Consolidated public sector debt stock (ceiling) | 516,331 | 514,841 | 613,000 | 483,061 | 480,897 | 640,000 | 500,255 | 497,346 | 650,000 |
| B. Monetary Targets | | | | | | | | | |
| 6. Stock of net international reserves of the central bank (in US\$ millions) (floor) | -5,432 | -4,276 | -3,900 | -5,000 | -3,616 | -3,900 | -5,578 | -2,626 | -2,250 |
| 7. Stock of adjusted monetary base 2/ | 37,250 | 36,813 | 37,650 | 37,650 | 37,991 | 37,200 | 37,200 | 40,921 | 40,400 |
| 8. Stock of net domestic assets of the central bank (ceiling) | 58,165 | 53,275 | 52,665 | 56,899 | 51,912 | 52,215 | 58,674 | 51,032 | 49,063 |

1/ As defined in the Technical Memorandum of Understanding (TMU); includes adjusters for January, March, and May as defined in the TMU.

2/ Indicative targets throughout the program period; May data preliminary, pending the BCRA quasi-fiscal results.

Table 3. Argentina: Net Debt Service to the IFIs, January–August 2003
(In millions of U.S. dollars)

| | Jan.-Jun. | | Jul.-Aug. | | Jan.-Aug. |
|---|-----------|----------|-----------|-------------|-----------|
| | Program | Estimate | Program | Estimate 1/ | Program |
| IMF 2/ | | | | | |
| A. Debt service | 5,142 | 5,132 | 1,411 | 1,395 | 6,553 |
| B. Disbursements and extensions of repurchase expectations | 5,009 | 5,009 | 1,544 | 1,544 | 6,553 |
| C. Net debt service (A-B) | 133 | 123 | -133 | -149 | 0 |
| World Bank | | | | | |
| A. Debt service | 2,073 | 1,849 | 164 | 163 | 2,237 |
| B. Disbursements | 1,620 | 1,246 | 610 | 984 | 2,230 |
| C. Net debt service (A-B) | 453 | 603 | -446 | -821 | 7 |
| IDB | | | | | |
| A. Debt service | 1,903 | 1,915 | 88 | 86 | 1,991 |
| B. Disbursements | 2,081 | 1,090 | 100 | 1,091 | 2,181 |
| C. Net debt service (A-B) | -178 | 825 | -12 | -1,005 | -190 |

Sources: IMF; World Bank; and IDB staff.

1/ Assumes that disbursements in June–August would make up for shortfalls in the January–May period and for the program period as a whole disbursements would reach the program levels.

2/ Assumes an exchange rate of US\$1.32408 per SDR.

Table 4. Argentina: Federal Government Operations, 1999-2003

| | 1999 | 2000 | 2001 | 2002 | 2003 | | |
|--|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| | | | | | Jan-Jun 2/ | | |
| | | | | | Act. | Prog. | Year 3/ |
| (In billions of pesos) | | | | | | | |
| Revenues | 55.0 | 55.5 | 50.4 | 55.1 | 36.7 | 35.6 | 72.9 |
| Tax revenues | 38.6 | 40.7 | 37.2 | 40.0 | 28.8 | 27.2 | 56.9 |
| Social security contributions | 10.9 | 10.7 | 9.6 | 9.7 | 5.5 | 5.6 | 11.0 |
| Non-tax revenues 1/ | 5.5 | 4.1 | 3.6 | 5.3 | 2.5 | 2.8 | 4.9 |
| | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Primary expenditure | 54.0 | 52.7 | 50.0 | 52.8 | 31.8 | 31.1 | 65.2 |
| Primary expenditures, <i>of which:</i> | 36.1 | 34.7 | 33.1 | 36.3 | 21.2 | 21.5 | 44.3 |
| Wages | 8.5 | 8.1 | 7.7 | 8.0 | 4.7 | 4.6 | 10.0 |
| Goods and services | 2.6 | 2.3 | 2.2 | 2.5 | 1.5 | 1.8 | 2.9 |
| Pensions | 17.4 | 17.4 | 16.6 | 16.5 | 8.8 | 8.5 | 18.2 |
| Transfers to private sector | 6.4 | 6.2 | 5.8 | 8.7 | 5.5 | 5.6 | 11.5 |
| Capital | 1.0 | 0.7 | 0.6 | 0.5 | 0.5 | 0.7 | 1.3 |
| Transfers to provinces | 17.8 | 18.0 | 17.0 | 16.5 | 10.7 | 9.5 | 20.9 |
| Primary cash balance | 1.1 | 2.7 | 0.3 | 2.3 | 4.9 | 4.5 | 7.7 |
| Interest cash | 8.2 | 9.7 | 10.2 | 6.8 | 3.5 | 6.7 | 7.4 |
| Overall cash balance | -7.2 | -6.9 | -9.8 | -4.6 | 1.4 | -2.2 | 0.3 |
| (In percent of GDP) | | | | | | | |
| Revenues | 19.4 | 19.5 | 18.8 | 17.6 | 10.1 | 9.7 | 20.0 |
| Tax revenues | 13.6 | 14.3 | 13.8 | 12.8 | 7.9 | 7.5 | 15.6 |
| Social security contributions | 3.8 | 3.8 | 3.6 | 3.1 | 1.5 | 1.5 | 3.0 |
| Non-tax revenues | 1.9 | 1.4 | 1.3 | 1.7 | 0.7 | 0.8 | 1.4 |
| Primary expenditure | 19.0 | 18.6 | 18.6 | 16.9 | 8.7 | 8.5 | 17.9 |
| Primary expenditure, <i>of which:</i> | 12.7 | 12.2 | 12.3 | 11.6 | 5.8 | 5.9 | 12.1 |
| Wages | 3.0 | 2.8 | 2.9 | 2.6 | 1.3 | 1.3 | 2.7 |
| Goods and services | 0.9 | 0.8 | 0.8 | 0.8 | 0.4 | 0.5 | 0.8 |
| Pensions | 6.1 | 6.1 | 6.2 | 5.3 | 2.4 | 2.3 | 5.0 |
| Private sector transfers | 2.3 | 2.2 | 2.2 | 2.8 | 1.5 | 1.5 | 3.2 |
| Capital | 0.3 | 0.2 | 0.2 | 0.1 | 0.1 | 0.2 | 0.4 |
| Provincial transfers | 6.3 | 6.3 | 6.3 | 5.3 | 2.9 | 2.6 | 5.7 |
| Primary cash balance | 0.4 | 1.0 | 0.1 | 0.7 | 1.4 | 1.2 | 2.1 |
| Interest cash | 2.9 | 3.4 | 3.8 | 2.2 | 1.0 | 1.8 | 2.0 |
| Overall cash balance | -2.5 | -2.4 | -3.7 | -1.5 | 0.4 | -0.6 | 0.1 |

Source: Ministry of Economy.

1/ Includes BCRA profit transfers.

2/ Based on preliminary data for June.

3/ Projections.

Table 5. Argentina: Federal Government Tax Revenue, 2002 and 2003

| | 2002 | | | 2003 | | | |
|--------------------------------------|--------------|-------------|-------------|-------------|-------------|-------------|-------------|
| | H1 | H2 | Year | H1 | H1 Prg | H2 /1 | Year /1 |
| (In billions of pesos) | | | | | | | |
| Total revenue | 26.8 | 34.9 | 61.7 | 35.5 | 33.8 | 35.0 | 70.5 |
| Tax revenue | 22.3 | 30.0 | 52.3 | 30.3 | 28.4 | 29.7 | 60.0 |
| Income tax | 3.7 | 5.2 | 8.9 | 7.5 | 4.5 | 6.0 | 13.4 |
| VAT | 6.9 | 8.4 | 15.2 | 9.2 | 10.5 | 10.5 | 19.7 |
| Fuel taxes | 1.9 | 2.5 | 4.4 | 2.4 | 2.4 | 2.6 | 5.0 |
| Financial transaction tax | 2.2 | 2.6 | 4.9 | 2.8 | 2.6 | 3.0 | 5.8 |
| Trade taxes | 1.9 | 4.4 | 6.3 | 5.6 | 6.3 | 5.1 | 10.7 |
| Export tax | 1.4 | 3.7 | 5.0 | 4.7 | 5.1 | 4.0 | 8.8 |
| Import tariffs | 0.5 | 0.8 | 1.3 | 0.9 | 1.2 | 1.1 | 1.9 |
| Other taxes | 5.7 | 6.9 | 12.6 | 2.9 | 2.2 | 2.5 | 5.4 |
| Social Security contributions | 4.4 | 5.0 | 9.4 | 5.2 | 5.4 | 5.3 | 10.5 |
| (12 month percent change) | | | | | | | |
| Total revenue | 5.4 | 56.4 | 29.3 | 32.8 | 26.4 | 0.1 | 14.3 |
| Tax revenue | 9.3 | 67.0 | 36.3 | 35.9 | 27.5 | -1.0 | 14.7 |
| Income tax | -35.5 | 20.4 | -11.6 | 99.8 | 20.5 | 15.2 | 50.6 |
| VAT | -19.9 | 23.7 | -0.7 | 34.2 | 51.9 | 25.0 | 29.2 |
| Fuel taxes | 24.4 | 32.3 | 28.7 | 21.5 | 22.0 | 7.1 | 13.4 |
| Financial transaction tax | 191.7 | 21.6 | 65.6 | 24.6 | 18.8 | 13.4 | 18.5 |
| Trade taxes | 105.2 | 545.7 | 294.7 | 201.1 | 235.8 | 14.9 | 70.0 |
| Other taxes | 101.8 | 220.1 | 153.1 | -48.9 | -60.6 | -63.4 | -56.8 |
| Social Security contributions | -10.4 | 12.8 | 0.5 | 17.0 | 21.2 | 7.0 | 11.7 |

Source: Ministry of Economy.

1/ Projections

Table 6. Argentina: Provincial Government Operations, 1998-2003

| | 1998 | 1999 | 2000 | 2001 | Prel. 2002 | Q1 | | Prog. 2003 |
|---|------|------|------|------|---------------|---------------|---------------|---------------|
| | | | | | | Prog. 2003 | Prel. 2003 | Prog. 2003 |
| (In billions of pesos) | | | | | | | | |
| Revenue | 32.8 | 31.8 | 32.5 | 28.9 | 30.8 | 7.9 | 8.5 | 38.8 |
| Own revenue | 14.5 | 14.0 | 14.5 | 12.9 | 13.5 | 3.6 | 4.3 | 17.9 |
| Taxes | 11.7 | 11.0 | 10.9 | 9.8 | 9.7 | 2.6 | 3.6 | 12.8 |
| Nontaxes | 2.8 | 2.9 | 3.6 | 3.2 | 3.8 | 1.1 | 0.7 | 5.1 |
| Transfers from federal government | 18.3 | 17.8 | 18.0 | 15.9 | 17.2 | 4.3 | 4.2 | 20.9 |
| Primary expenditures 1/ | 33.9 | 35.0 | 34.0 | 34.0 | 32.3 | 7.6 | 8.1 | 36.7 |
| Personnel | 16.8 | 18.0 | 18.6 | 18.8 | 17.9 | 4.7 | 4.3 | 20.5 |
| Other | 17.0 | 16.9 | 15.4 | 15.2 | 14.4 | 2.9 | 3.8 | 16.2 |
| Goods and services | 3.8 | 4.1 | 3.7 | 3.9 | 3.7 | 0.6 | 0.9 | 4.1 |
| Private sector transfers | 3.1 | 3.4 | 3.2 | 3.2 | 3.2 | 0.7 | 0.9 | 3.5 |
| Transfers to municipalities | 4.9 | 4.8 | 4.9 | 4.8 | 4.6 | 1.1 | 1.4 | 5.7 |
| Other (capital) | 5.2 | 4.7 | 3.6 | 3.3 | 2.9 | 0.5 | 0.6 | 2.9 |
| Primary balance (commitment) | -1.1 | -3.1 | -1.5 | -5.1 | -1.6 | 0.3 | 0.4 | 2.1 |
| Interest (cash) 2/ | 1.2 | 1.4 | 1.9 | 2.4 | 1.5 | 0.7 | 0.3 | 3.2 |
| Net arrears reduction (-, accumulation) | 0.0 | 0.0 | 0.0 | 0.0 | 1.3 | ... | ... | ... |
| Cash balance | -2.3 | -4.6 | -3.3 | -7.5 | -4.3 | -0.4 | 0.1 | -1.1 |
| Interest capitalization | 0.0 | 0.0 | 0.0 | 0.0 | 10.6 | 3.5 | 1.3 | 12.5 |
| Overall balance | -2.3 | -4.6 | -3.3 | -7.5 | -14.9 | -3.8 | -1.2 | -13.6 |
| Interest arrears | 0.0 | 0.0 | 0.0 | 0.0 | 1.4 | 1.2 | 0.5 | 4.9 |
| Augmented balance | -2.3 | -4.6 | -3.3 | -7.5 | -16.3 | -5.0 | -1.7 | -18.4 |
| (In percent of GDP) | | | | | | | | |
| Revenue | 11.0 | 11.2 | 11.4 | 10.7 | 9.1 | 8.2 | 10.4 | 9.8 |
| Own revenue | 4.8 | 4.9 | 5.1 | 4.8 | 4.0 | 3.8 | 5.2 | 4.5 |
| Taxes | 3.9 | 3.9 | 3.8 | 3.6 | 2.9 | 2.7 | 4.4 | 3.2 |
| Nontaxes | 0.9 | 1.0 | 1.3 | 1.2 | 1.1 | 1.1 | 0.9 | 1.3 |
| Transfers from federal government | 6.1 | 6.3 | 6.3 | 5.9 | 5.1 | 4.5 | 5.2 | 5.3 |
| Primary expenditures 1/ | 11.3 | 12.3 | 12.0 | 12.6 | 9.5 | 7.9 | 9.9 | 9.3 |
| Personnel | 5.6 | 6.4 | 6.5 | 7.0 | 5.3 | 4.9 | 5.3 | 5.2 |
| Other | 5.7 | 6.0 | 5.4 | 5.7 | 4.3 | 3.0 | 4.6 | 4.1 |
| Primary balance (commitment) | -0.4 | -1.1 | -0.5 | -1.9 | -0.5 | 0.3 | 0.5 | 0.5 |
| Interest (cash) 2/ | 0.4 | 0.5 | 0.7 | 0.9 | 0.4 | 0.7 | 0.4 | 0.8 |
| Net arrears reduction (-, accumulation) | 0.0 | 0.0 | 0.0 | 0.0 | 0.4 | ... | ... | ... |
| Cash balance | -0.8 | -1.6 | -1.2 | -2.8 | -1.3 | -0.4 | 0.1 | -0.3 |
| Interest capitalization | 0.0 | 0.0 | 0.0 | 0.0 | 3.1 | 3.6 | 1.6 | 3.2 |
| Overall balance | -0.8 | -1.6 | -1.2 | -2.8 | -4.4 | -4.0 | -1.5 | -3.4 |
| Interest arrears | 0.0 | 0.0 | 0.0 | 0.0 | 0.4 | 1.3 | 0.6 | 1.2 |
| Augmented balance | -0.8 | -1.6 | -1.2 | -2.8 | -4.8 | -5.2 | -2.1 | -4.7 |

Sources: Ministry of Economy; and Fund staff estimates.

1/ Expenditures on a commitments basis.

2/ For 1998 to 2000, there is little difference between the cash and commitment interest obligations.

Table 7. Argentina: Selected Economic and Financial Indicators, 1998–2006

| | 1998 | 1999 | 2000 | 2001 | 2002 | Proj. 2003 |
|---|-------|-------|-------|-------|-------|---------------|
| (Annual percentage changes; unless otherwise indicated) | | | | | | |
| National income and prices | | | | | | |
| GDP at constant prices | 3.8 | -3.4 | -0.8 | -4.4 | -10.9 | 4.8 |
| Consumer prices (average) | 0.9 | -1.2 | -0.9 | -1.1 | 23.9 | 14.0 |
| Consumer prices (end-of-period) | 0.7 | -1.8 | -0.7 | -1.5 | 41.0 | 8.0 |
| Social indicators | | | | | | |
| Population below poverty line (in percent) | 24.3 | 27.1 | 29.7 | 35.4 | 49.7 | ... |
| Population below extreme poverty line (in percent) | 5.3 | 7.6 | 7.5 | 12.2 | 22.7 | ... |
| External sector | | | | | | |
| Exports, f.o.b. (in terms of U.S. dollars) | 1.0 | -11.8 | 13.3 | 0.8 | -4.7 | 9.4 |
| Imports, c.i.f. (in terms of U.S. dollars) | 3.1 | -18.8 | -1.0 | -19.5 | -55.8 | 43.1 |
| Export volume | 11.6 | -0.7 | 2.7 | 4.6 | -0.3 | 3.3 |
| Import volume | 8.7 | -13.9 | -0.9 | -17.3 | -54.5 | 39.5 |
| Terms of trade (deterioration -) | -5.5 | -5.9 | 10.2 | -0.6 | -1.1 | 3.7 |
| Real effective exchange rate | | | | | | |
| Average (depreciation -) | 3.5 | 12.4 | -0.7 | 6.0 | -57.3 | ... |
| Year-end (depreciation -) | 0.3 | 12.6 | 1.7 | 2.9 | -54.7 | ... |
| Money and credit 1/ | | | | | | |
| Net domestic assets of the financial system | 17.1 | 8.9 | -1.3 | 1.3 | 73.7 | -4.6 |
| of which: credit to private sector | 12.4 | -2.3 | -3.8 | -17.6 | -21.8 | -12.7 |
| Broad money | 13.1 | 3.2 | 3.2 | -19.7 | 17.0 | 32.2 |
| Income velocity of broad money 2/ | 0.3 | 0.3 | 0.3 | 0.3 | 0.4 | 0.2 |
| Interest rate (30-day deposit rate, in percent) | 7.6 | 8.0 | 8.3 | 16.2 | 41.8 | ... |
| (In percent of GDP) | | | | | | |
| Public sector savings | 0.1 | -2.2 | -2.1 | -4.6 | -1.5 | 0.9 |
| Consolidated public sector primary balance, cash | 0.5 | -0.8 | 0.5 | -1.4 | 0.3 | 2.5 |
| of which: Federal government | 0.9 | 0.4 | 1.0 | 0.1 | 0.7 | 2.1 |
| Consolidated public sector overall balance, cash | -2.1 | -4.2 | -3.6 | -6.1 | -2.3 | 0.2 |
| Revenues | 23.7 | 24.3 | 24.5 | 23.6 | 22.3 | 25.0 |
| Expenditures | 25.8 | 28.5 | 28.1 | 29.6 | 24.6 | 24.7 |
| Gross domestic investment | 19.9 | 18.0 | 16.2 | 14.2 | 12.0 | 14.8 |
| Gross national savings | 15.0 | 13.8 | 13.1 | 12.5 | 21.5 | 21.0 |
| Current account deficit | -4.9 | -4.2 | -3.1 | -1.7 | 9.5 | 6.3 |
| Public sector total debt (end-of-year) | 37.6 | 43.0 | 45.0 | 53.8 | 149.1 | 133.0 |
| Public sector external debt (end-of-year) | 27.8 | 29.9 | 29.9 | 32.9 | 96.1 | 68.2 |
| (In percent of exports of goods and nonfactor services; unless otherwise indicated) | | | | | | |
| Public sector debt service | 37.8 | 49.4 | 54.8 | 65.0 | 46.8 | 63.9 |
| Outstanding use of Fund resources | | | | | | |
| (in percent of quota at end-of-period) | 251.5 | 154.1 | 183.2 | 525.3 | 498.2 | 516.0 3/ |
| Gross foreign exchange reserves 4/ | 8.2 | 10.1 | 9.8 | 6.6 | 8.6 | 11.3 |

Sources: Ministry of Economy and Fund staff estimates.

1/ Based on June 2002 data for financial sector and June 2003 data for BCRA. Foreign currency items in projections are valued at the June 2003 exchange rate of Arg\$2.794 per U.S. dollar.

2/ Measured in terms of monthly GDP.

3/ Projection to end-August 2003.

4/ In months of imports of goods and nonfactor services.

Table 8. Argentina: Summary Balance of Payments, 1998-2003

| | 1998 | 1999 | 2000 | 2001 | 2002 | Proj. 2003 |
|---|--------------|--------------|--------------|--------------|--------------|---------------|
| (In billions of U.S. dollars) | | | | | | |
| Current account | -14.5 | -11.9 | -8.8 | -4.5 | 9.6 | 7.8 |
| Trade balance | -5.0 | -2.2 | 1.1 | 6.2 | 16.7 | 15.3 |
| Exports f.o.b. | 26.4 | 23.3 | 26.3 | 26.5 | 25.7 | 28.1 |
| <i>Of which:</i> oil products (net) | 1.6 | 2.3 | 3.9 | 3.9 | 4.1 | 4.4 |
| Imports c.i.f. | -31.4 | -25.5 | -25.2 | -20.3 | -9.0 | -12.9 |
| Services and transfers | -9.6 | -9.7 | -9.9 | -10.7 | -7.1 | -7.5 |
| <i>Of which:</i> net interest payments | -5.1 | -5.9 | -5.9 | -7.4 | -7.1 | -7.2 |
| Capital and Financial Account | 18.4 | 14.0 | 7.8 | -16.5 | -25.9 | -20.5 |
| Net public sector capital | 9.5 | 10.6 | 8.1 | -2.1 | -6.0 | -7.4 |
| Direct investment | 4.6 | 7.2 | 8.4 | 3.4 | 1.7 | 0.4 |
| Other net private sector capital 1/ | 4.3 | -3.9 | -8.7 | -17.8 | -21.6 | -13.4 |
| Overall balance | 3.9 | 2.1 | -1.0 | -20.9 | -16.3 | -12.6 |
| Financing | -3.9 | -2.1 | 1.0 | 20.9 | 16.3 | 12.6 |
| Net international reserves (increase -) 2/ | -3.9 | -2.1 | 1.0 | 20.9 | 4.8 | -6.7 |
| Change in gross reserves | -3.4 | -1.1 | 0.4 | 12.0 | 4.4 | -4.0 |
| Change in reserve liabilities (IMF) | 0.4 | 1.0 | -0.6 | -8.9 | -0.4 | 2.7 |
| Exceptional financing | 0.0 | 0.0 | 0.0 | 0.0 | 11.5 | 19.3 |
| Arrears | 0.0 | 0.0 | 0.0 | 0.0 | 11.5 | 12.5 |
| Rescheduling | ... | ... | ... | ... | ... | 1.0 |
| Other 3/ | ... | ... | ... | ... | ... | 5.7 |
| (In percent of GDP, unless otherwise specified) | | | | | | |
| Current account | -4.9 | -4.2 | -3.1 | -1.7 | 9.5 | 6.3 |
| Trade account | -1.7 | -0.8 | 0.4 | 2.3 | 16.5 | 12.2 |
| Exports, f.o.b. | 8.8 | 8.2 | 9.3 | 9.9 | 25.3 | 22.5 |
| <i>Of which:</i> oil products (net) | 0.5 | 0.8 | 1.4 | 1.4 | 4.1 | 3.5 |
| Imports c.i.f. | -10.5 | -9.0 | -8.9 | -7.6 | -8.9 | -10.3 |
| External debt | 47.5 | 51.2 | 51.6 | 52.2 | 144.4 | 99.3 |
| <i>Of which:</i> public sector | 27.8 | 29.9 | 29.9 | 32.9 | 96.1 | 68.2 |
| External debt service ratio 4/ | 76.1 | 100.3 | 105.2 | 108.4 | 98.4 | 119.9 |
| <i>Of which:</i> public sector debt | 37.8 | 49.4 | 54.8 | 65.0 | 46.8 | 63.9 |
| Memorandum items: | | | | | | |
| Exports volumes, percent change | 11.6 | -0.7 | 2.7 | 4.6 | -0.3 | 3.3 |
| Imports volumes, percent change | 8.7 | -13.9 | -0.9 | -17.3 | -54.5 | 39.5 |
| Net international reserves 2/ 5/ | 6.8 | 8.7 | 8.3 | 0.4 | -3.7 | -0.4 |
| (in billions of U.S. dollars) 2/ | 20.8 | 22.9 | 21.9 | 0.9 | -3.9 | -0.6 |

Sources: Ministry of Economy; and Fund staff estimates.

1/ Includes errors and omissions.

2/ For 2003, it includes purchases under the transitional program. Fund repurchases are on an obligations basis.

3/ Reflects financing required to close the financing gap in the September-December 2003 period.

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

5/ In months of imports of goods and nonfactor services.

Table 9. Argentina: External Financing Requirements and Sources, 2000-03

(In billions of U.S. dollars)

| | 2001 | 2002 | 2003 |
|--|-------------|-------------|-------------|
| Gross financing requirements | 58.8 | 31.7 | 32.6 |
| Current account deficit | 4.5 | -9.6 | -7.8 |
| Capital outflows | 54.4 | 41.2 | 40.4 |
| Public sector amortization | 21.2 | 7.7 | 16.9 |
| IMF | 1.2 | 0.8 | 5.7 |
| Multilateral loans | 0.9 | 2.6 | 3.8 |
| Official bilateral creditors | 0.5 | 0.5 | 0.7 |
| Bonds and notes | 7.2 | 3.1 | 6.4 |
| Other | 11.5 | 0.7 | 0.2 |
| Private sector amortization | 17.0 | 20.0 | 14.5 |
| Other private sector flows, net (+outflows) 1/ | 16.1 | 13.6 | 9.1 |
| Available financing | 58.8 | 31.7 | 18.5 |
| Capital inflows | 46.8 | 27.2 | 22.5 |
| Foreign direct investment | 3.4 | 1.7 | 0.4 |
| Disbursements to public sector | 28.1 | 0.8 | 0.0 |
| Private sector borrowing | 15.3 | 13.2 | 9.5 |
| Exceptional financing | 0.0 | 11.5 | 12.5 |
| Public sector arrears accumulation | 0.0 | 7.8 | 7.6 |
| Private sector arrears accumulation | 0.0 | 3.7 | 5.0 |
| Gross reserves accumulation (- increase) | 12.0 | 4.4 | -4.0 |
| Financing gap | 0.0 | 0.0 | 14.1 |
| Transitional program | ... | ... | 7.4 |
| IMF | ... | ... | 3.0 |
| World Bank | ... | ... | 2.2 |
| IDB | ... | ... | 2.2 |
| Rescheduling | ... | ... | 1.0 |
| Residual financing gap 2/ | ... | ... | 5.7 |

Sources: BCRA; and Fund staff estimates.

1/ Includes errors and omissions.

2/ Assuming no Fund successor arrangement or new IFI financing.

Table 10. Argentina: Summary Operations of the Financial System, 1998-2003 1/

(In billions of pesos, end of period)

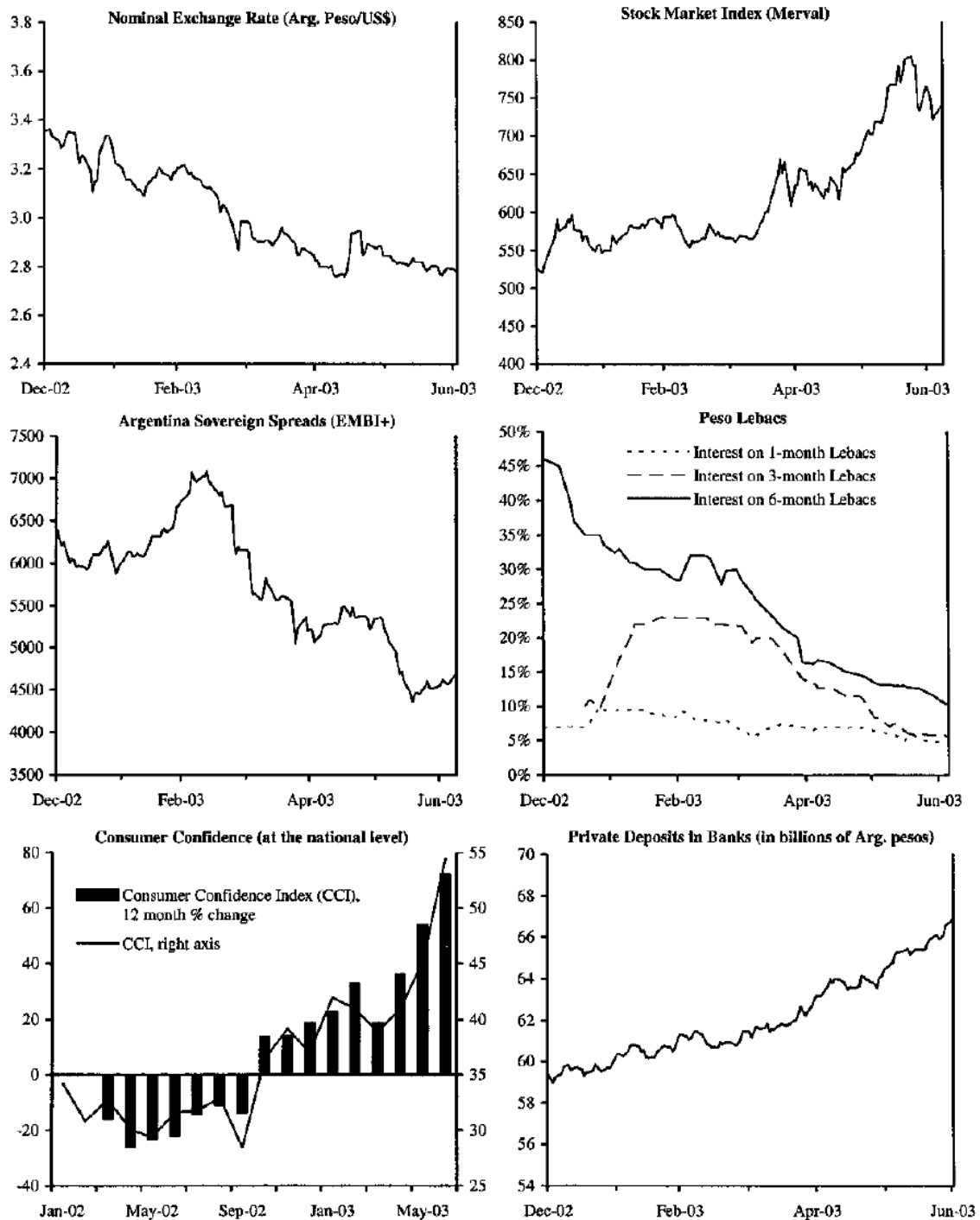
| | 1998 | 1999 | 2000 | 2001 | 2002 | Jun 2003 | Proj. 2003 |
|--|-------|-------|-------|-------|-------|-------------|---------------|
| I. Central Bank | | | | | | | |
| Net international reserves 2/ | 13.1 | 13.4 | 12.5 | 3.2 | -17.0 | -11.5 | -4.8 |
| Net domestic assets | 3.3 | 3.1 | 2.5 | 8.7 | 46.1 | 49.1 | 47.3 |
| Credit public sector (net) | 5.6 | 5.3 | 5.3 | 12.3 | 54.1 | 53.3 | 51.8 |
| Credit to the financial sector (net) | 1.5 | 1.3 | 1.0 | -0.9 | 22.4 | 15.7 | 15.7 |
| Official capital and surplus and other assets (net) | -3.7 | -3.5 | -3.7 | -2.7 | -30.4 | -19.9 | -20.2 |
| Monetary base | 16.4 | 16.5 | 15.1 | 11.9 | 29.2 | 37.7 | 42.6 |
| Currency issued | 16.4 | 16.5 | 15.1 | 11.0 | 18.8 | 22.2 | 28.1 |
| Bank deposits at the central bank (in pesos) | ... | ... | ... | 0.9 | 10.3 | 15.4 | 14.4 |
| II. Banks and Nonbank Financial Institutions | | | | | | | |
| Net foreign assets | 1.5 | -2.1 | 2.4 | -6.2 | -27.6 | -16.8 | -8.1 |
| Net domestic assets | 66.0 | 72.0 | 71.3 | 66.4 | 92.2 | 89.3 | 89.3 |
| Credit to public sector (net) | 14.2 | 18.8 | 19.7 | 24.1 | 76.3 | 70.3 | 70.3 |
| Credit to private sector | 72.2 | 70.6 | 67.9 | 56.0 | 43.7 | 38.8 | 38.2 |
| Claims on central bank (net) | 3.5 | 3.8 | 3.5 | 4.7 | -10.3 | -4.8 | -5.8 |
| Capital and reserves | -17.0 | -16.9 | -17.3 | -16.5 | -21.6 | -14.4 | -13.8 |
| Other | -6.8 | -4.3 | -2.5 | -1.9 | 4.1 | -0.6 | 0.4 |
| Private sector deposits | 67.5 | 69.9 | 73.7 | 60.2 | 64.6 | 72.5 | 81.2 |
| Local currency | 28.1 | 26.7 | 26.0 | 15.9 | 63.0 | 69.9 | 78.6 |
| Foreign currency | 39.4 | 43.2 | 47.7 | 44.2 | 1.7 | 2.6 | 2.6 |
| III. Consolidated Financial System | | | | | | | |
| Net foreign assets | 14.6 | 11.3 | 14.9 | -3.0 | -44.5 | -28.2 | -12.8 |
| Net domestic assets | 66.4 | 72.3 | 71.4 | 72.3 | 125.6 | 120.7 | 119.9 |
| Credit to public sector (net) | 19.7 | 24.1 | 25.0 | 36.4 | 130.4 | 123.6 | 122.1 |
| Credit private sector | 72.2 | 70.6 | 67.9 | 56.0 | 43.7 | 38.8 | 38.2 |
| Net capital, reserves, and other assets | -25.5 | -22.4 | -21.5 | -20.1 | -48.6 | -41.6 | -40.3 |
| Liabilities to private sector (broad money) | 81.0 | 83.6 | 86.3 | 69.3 | 81.0 | 92.5 | 107.1 |
| Currency in circulation | 13.5 | 13.7 | 12.6 | 9.1 | 16.4 | 20.0 | 25.9 |
| Local currency deposits | 28.1 | 26.7 | 26.0 | 15.9 | 63.0 | 69.9 | 78.6 |
| Foreign currency deposits | 39.4 | 43.2 | 47.7 | 44.2 | 1.7 | 2.6 | 2.6 |
| Memorandum items: | | | | | | | |
| Stock of central bank paper (<i>Lebac</i> s) | ... | ... | ... | ... | 3.2 | 6.0 | 6.3 |
| (Annual percent change) | | | | | | | |
| Base money | 2.5 | 0.7 | -8.7 | -21.0 | 145.1 | 86.6 | 46.0 |
| Broad money | 13.1 | 3.2 | 3.2 | -19.7 | 17.0 | 23.4 | 32.2 |
| Credit to private sector | 12.4 | -2.3 | -3.8 | -17.6 | -21.8 | -27.9 | -12.7 |

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

1/ Based on BCRA data up to June 2003 and financial system data up to June 2002. Foreign currency items in projections are valued at the June 2003 exchange rate of Arg\$2.794 per U.S. dollar.

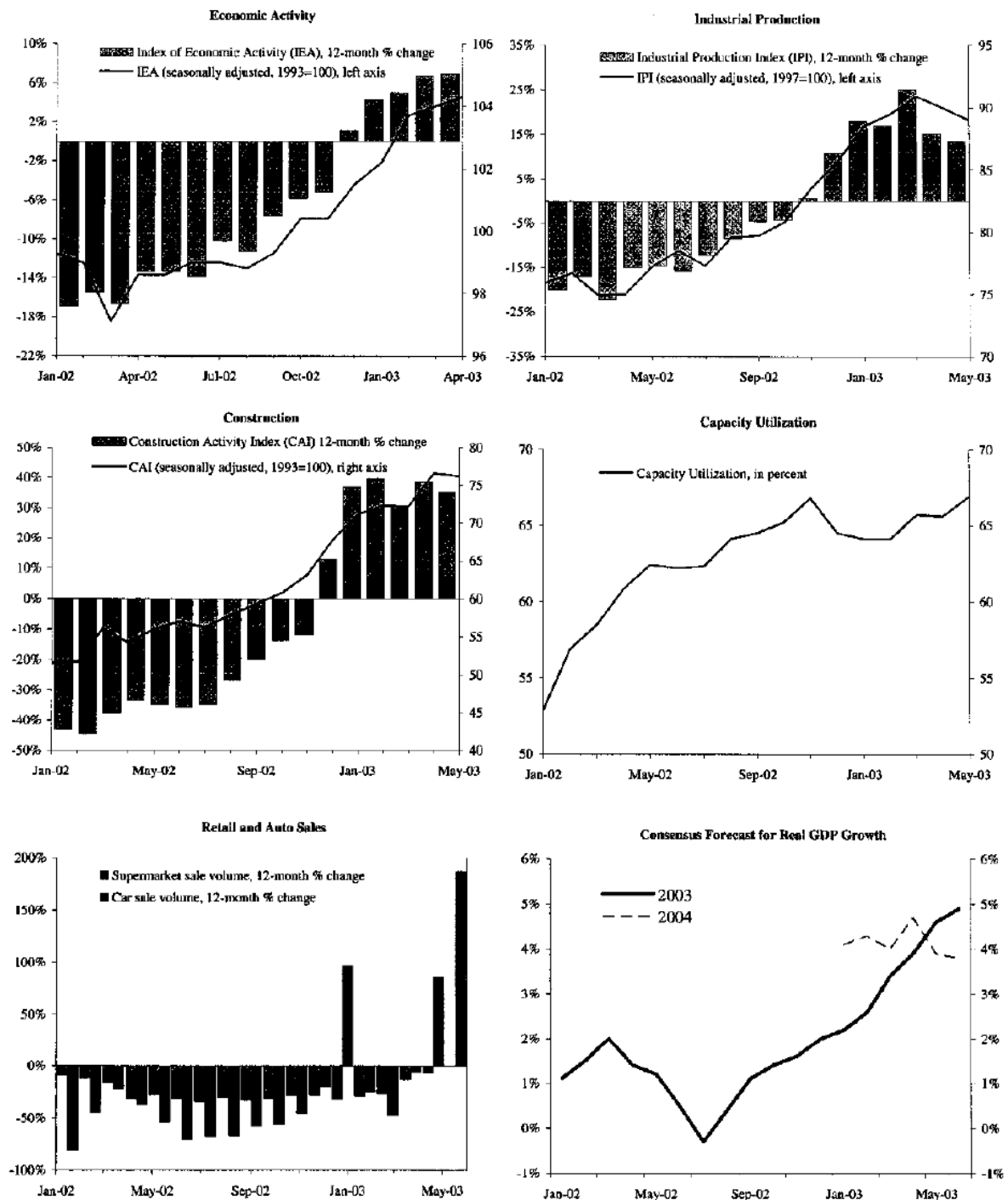
2/ Foreign liabilities include only liabilities to the IMF. Historical gross reserve numbers have been revised from previous versions to exclude foreign currency securities repurchased by BCRA to banks.

Figure 1. Argentina: Confidence Indicators



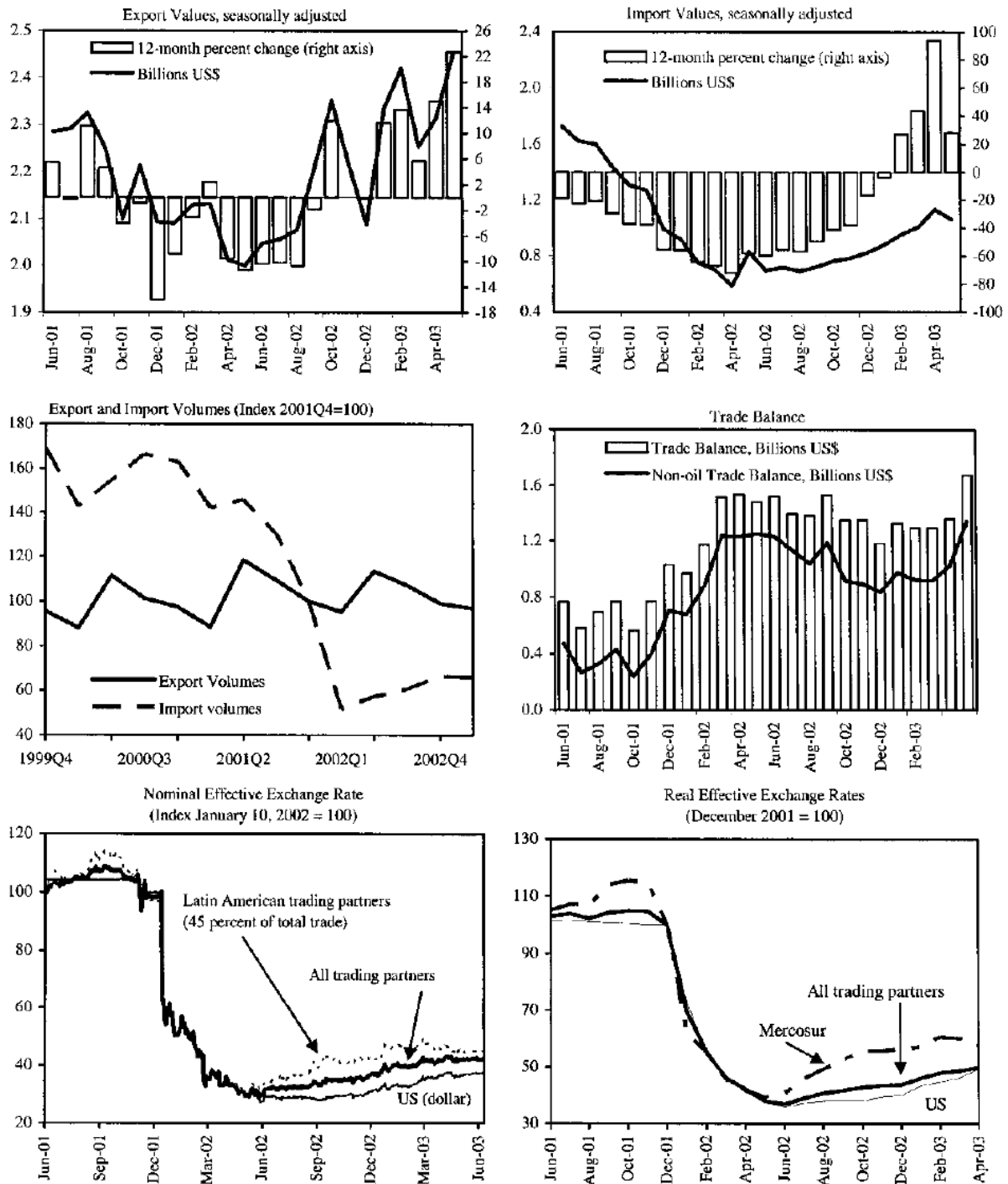
Sources: Central Bank of Argentina; Ministry of Economy; and INDEC.

Figure 2. Argentina: Indicators of Real Activity



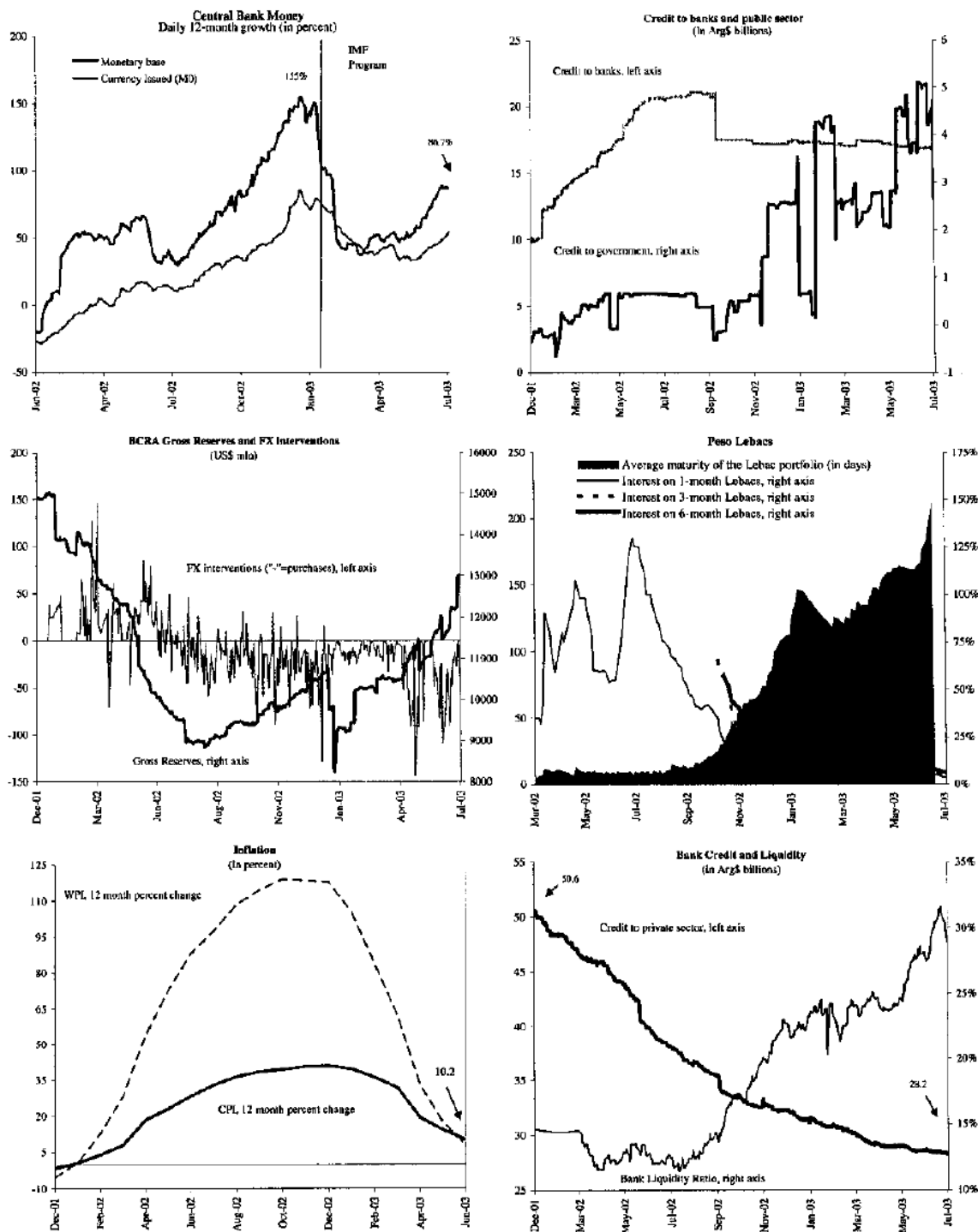
Sources: Ministry of Economy of Argentina; and INDEC.

Figure 3. Argentina: External Sector Developments



Sources: Argentina Ministry of Finance; and Fund staff estimates.

Figure 4. Argentina: Recent Monetary Developments



Source: Central Bank of Argentina.

ARGENTINA—FUND RELATIONS
(As of April 30, 2003)

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

A. Financial Relations

| II. General Resources Account: | In millions of SDRs | In percent of Quota |
|---|--------------------------------|----------------------------------|
| Quota | 2,117.10 | 100.00 |
| Fund holdings of currency | 12,724.72 | 601.04 |
| Reserve position in Fund | 0.02 | 0.00 |
| III. SDR Department: | In millions of SDRs | Percent of Allocation |
| Net cumulative allocation | 318.37 | 100.00 |
| Holdings | 736.31 | 231.27 |
| IV. Outstanding Purchases and Loans: | In millions of SDRs | In percent of Quota |
| Stand-By Arrangements | 9,988.53 | 471.80 |
| Extended Fund arrangements | 619.11 | 29.24 |

V. Latest Financial Arrangements

| Type | Approval Date | Expiration Date | SDR Millions | |
|----------------------|--------------------------|----------------------------|----------------------------|-------------------------|
| | | | Amount Approved | Amount Drawn |
| Stand-By | 01/24/03 | 08/31/03 | 2,174.50 | 973.20 |
| Stand-By | 03/10/00 | 01/23/03 | 16,936.80 | 9,756.31 |
| <i>Of which: SRF</i> | 01/12/01 | 01/11/02 | 6,086.66 | 5,874.95 |
| EFF | 02/04/98 | 03/10/00 | 2,080.00 | 0.00 |

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

| | Forthcoming | | | | |
|------------------|--------------------|-------------|-------------|-------------|-------------|
| | 2003 | 2004 | 2005 | 2006 | 2007 |
| Principal | 3,876.42 | 4,971.15 | 1,130.47 | 507.95 | 121.65 |
| Charges/interest | 327.31 | 141.09 | 31.29 | 10.34 | 0.85 |
| Total | 4203.73 | 5,112.23 | 1,161.76 | 518.29 | 122.5 |

- VII. Safeguards Assessments:** Under the Fund's safeguards assessment policy, the Central Bank of Argentina (BCRA) is subject to an assessment with respect to the Stand-By Arrangement, which was approved on January 24, 2003 and is scheduled to expire on August 31, 2003. A safeguards assessment of the BCRA was completed on September 05, 2002. The assessment concluded that: (i) substantial risks might exist in the system of internal controls; (ii) a more robust financial reporting framework should be developed; and (iii) the central bank's operational independence from government interference needs strengthening. Staff recommendations included: (i) publication of the 2001 financial statement; (ii) strengthening of controls over the reporting of program data; (iii) issuance of a resolution requiring the preparation of financial statements in accordance with International Accounting Standards (IAS), by March 31, 2003; and (iv) signing of memorandum of understandings between the central bank and the government, determining the conditions under which realized central bank profits are transferred to the government, by the third review. The first two recommendations have been implemented. The authorities also informed the staff that they have initiated work for the presentation of the 2002 and 2003 BCRA accounts according to IAS, and that the MoU between the government and the BCRA is expected to be signed in July, 2003. Staff will continue monitoring the implementation of the recommended measures.

B. Nonfinancial Relations

- VIII. Exchange Rate:** On March 27, 1991, a law was passed guaranteeing the full convertibility of the austral under a currency board arrangement and pegging the austral at A10,000 per U.S. dollar. On January 1, 1992 the peso was substituted for the austral at a rate of 1 peso per 10,000 australes. On January 7, 2002, the currency board arrangement was abandoned in favor of a dual exchange rate regime with an official rate of Arg\$1.4 per U.S. dollar for most trade, trade finance, and public sector transactions; remaining transactions were at a market floating rate. On February 11, 2002, the dual exchange rate regime was abolished and substituted by a managed floating regime with no pre-announced rate of the exchange rate.
- IX. Last Article IV Consultation:** The 2002 Article IV consultation was concluded by the Executive Board on January 8, 2003 (EBS/02/214).
- X. Fourth Amendment:** Argentina has accepted the Fourth Amendment to the Articles of Agreement.

XI. Technical Assistance, 2002-03

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

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

ARGENTINA—RELATIONS WITH THE WORLD BANK GROUP¹

Bank lending to Argentina as of May 31, 2003 totaled US\$18.3 billion (net of cancellations). Thirty-one loans totaling US\$4 billion remain under execution, with about US\$1.7 billion undisbursed. The Bank's assistance has focused on supporting government efforts to: (i) enhance social development, including poverty alleviation and human resource development; (ii) improve performance and institutional capacity of sub-national governments to deliver key social and infrastructure services; and (iii) consolidate structural reforms, including reforms in public finances, labor markets and the financial sector to ensure successful implementation of the assistance program and enhance governance through institution building.

Out of the 31 ongoing loans, four adjustment operations have been under execution. One of them is a Structural Adjustment Loan (SAL) for US\$400 million. This loan was approved in August, 2001 as part of the joint IFI support to Argentina as the country began to slip deeper into the crisis at the end of 2000. In addition, three of the other adjustment loans are Provincial Reform Loans (PRLs) totaling US\$703 million—of which US\$296 remain undisbursed. These loans, approved between September 2000 and July 2001, are part of a continuing effort to assist selected provinces—in this case Catamarca, Córdoba, and Santa Fe—willing and able to undertake structural reforms in the social sectors, and improve fiscal performance and financial management. These operations complement the adjustment operations to the Federal Government, addressing many of the same concerns such as social equity and systemic changes in health and education and on basic economic management. During May 2003, the above mentioned SAL was fully disbursed as were two tranches of the Cordoba loan.

Following the worsening of the crisis in December 2001, the Bank responded to the social emergency by reallocating about US\$240 million of the existing portfolio to help finance expenditures in the areas of health, education and social protection.

During November 2002, the Bank carried out a joint Portfolio Review with the Government of Argentina, aimed at assessing performance during CY02, identifying prospects for the coming year and actions needed to ensure that the Bank's portfolio in Argentina contributes effectively to the country's development objectives in the short and medium term. The Bank has indicated during the joint Portfolio Review that the potential exists to reactivate the investment portfolio quickly, and to return to substantial monthly disbursements in the order of US\$40 million.

On December 13, 2002, Argentina failed to become current on all payments to the Bank, and consequently the Bank suspended, effective December 14, 2002, the borrower's rights to make withdrawals on all effective and not fully disbursed loans. Additionally, the Bank was

¹ Prepared by the staff of the World Bank on June 10, 2003.

not reimbursed for the payment made by the IBRD under its guarantee for the US\$250 million Series D Zero Coupon Notes issued by the Republic of Argentina and due October 15, 2002, and consequently the guarantee is no longer eligible for reinstatement and transfer to the remaining Series E and F notes. As of December 31, 2002, Argentina was in arrears to the Bank for US\$773.8 million.

On January 23, 2003, the World Bank received payment of US\$796.5 million from the Government of Argentina against outstanding loan payments that were due since October 15, 2002. The full clearance of arrears by the Argentine authorities allowed the World Bank to reactivate disbursements under existing loans, as well as to consider new loans to the country.

On January 28, the Bank approved the above-mentioned loan for US\$600 million for the Heads of Household Program, and resumed disbursements under the ongoing portfolio. The Bank is also providing technical assistance in areas such as finance, corporate restructuring and tariffs. New operations, focusing on the social sectors, are currently under preparation.

On May 23, the Bank approved an Economic and Social Transition Structural Adjustment Loan in the amount of \$500 million to help strengthen Argentina's ability to resume growth and protect its human capital through a series of initial reform steps taken by the outgoing administration, including the redemption of quasi-monies program, and set the basis for a longer-term reform program with the new Government. This has been fully disbursed in May 2003.

Financial Relations with the World Bank

(In millions of U.S. dollars)

| | Commitments (Net of Calculations) | Disburse- ments | Undisbursed Amount |
|--|--------------------------------------|--------------------|-----------------------|
| I. IBRD Operations (as of May 31, 2003) | | | |
| Fully disbursed loans | 14,296.1 | 14,296.1 | 0.0 |
| Loans in process of disbursement | 3,978.8 | 2,258.4 | 1,720.6 |
| A. Investment operations | | | |
| Agriculture and rural development | 251.6 | 91.7 | 159.9 |
| Power | 30.0 | 2.2 | 27.8 |
| Municipal/provincial development | 432.1 | 380.7 | 51.4 |
| Water sector | 30.0 | 3.6 | 26.5 |
| Social sector | 1,289.3 | 719.1 | 570.2 |
| Finance, infrastructure, and natural resources | 1,192.2 | 639.9 | 552.2 |
| Public administration | 50.80 | 14.2 | 36.6 |
| B. Adjustment operations | 703.0 | 407.00 | 296.00 |
| Total loans | 18,274.9 | 16,554.5 | 1,720.6 |

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

| | Loans | Equity | Quasi | Partici- pation |
|--------------------|-------|--------|-------|--------------------|
| Held | 743.7 | 195.1 | 208.1 | 940.6 |
| Disbursed | 725.7 | 135.1 | 208.1 | 933.1 |
| Pending commitment | 72.0 | 0.4 | 3.5 | 500.0 |

III. IBRD Loan Transactions

| | Actuals (Calendar Year) | | | | | |
|-----------------------|-------------------------|----------|----------|----------|-----------|----------|
| | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 |
| Disbursements | 2,030.60 | 1,572.90 | 1,018.80 | 1,328.80 | 424.50 | 1,153.10 |
| Debt service payments | 350.20 | 445.00 | 538.10 | 675.50 | 1,869.80 | 1,776.90 |
| Net transfers | 1,680.40 | 1,127.90 | 480.70 | 653.20 | -1,445.30 | -623.80 |

Source: World Bank.

1/ Includes repayment from third parties.

ARGENTINA—RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK⁸

Portfolio

1. The Bank's activities had to be adjusted in light of this new economic context, so as to:
 - encompass harsher fiscal constraints;
 - protect social expenditure, deepening the actions undertaken with respect to reformulation of the social portfolio;
 - support development of the productive sectors through loans to the provinces under the new agreement with the federal government and support for small- and medium-sized enterprises (SMEs), particularly export-oriented SMEs, and support a review of the portfolio relating to the productive sectors; and
 - help maintain policy reforms.
2. In March 2002, authorization was given to redirect US\$694.2 million from low-performing operations of lesser priority in the context of the social and economic crisis now affecting the country to the Argentine government's Social Emergency Plan for social protection and containment programs, particularly food, medicines, and education.
3. In a second stage, work is underway on a proposal to redirect resources from active projects that are unlikely to make progress again soon to initiatives that help revitalize economic activity and improve the competitiveness of the productive sectors. This revitalization package would total US\$400 million.
4. In early 2003 the second tranche of two sector loans have been reformulated in order to adapt to the new reality in Argentina: the Financial Sector Program in the amount of US\$243 million, and the Sector Program to Support the Federal Pact for Growth and Fiscal Discipline in the amount of US\$246.7 million. Each of these second tranches were split into two having already been disbursed the first part of each of them.
5. As of June 1, 2003 disbursements for the year totaled US\$1.1 billion with US\$1.8 billion remaining to be disbursed during the rest of the year.

⁸ Prepared by the staff of the IDB.

Lending Program and Country Strategy

1. Under the Transition Program agreed with the IMF, on February 5, 2003 an emergency loan of US\$1.5 billion was approved to protect social expenditure. The first tranche of US\$765 million was disbursed upon approval and the second and last tranche is expected to be disbursed by the end of June. Once priorities are discussed with the new government elected in May 2003 and a new agreement is reached between the IMF and the new government, an additional emergency loan in the amount of US\$1 billion could be approved.
2. Additionally, two direct loans to the provinces of Salta and Río Negro will be considered for 2003 with the main objective to revitalize economic growth by supporting sectors with greater comparative advantages.
3. An operation relating to the comparatively less-developed provinces which includes planning a long-term development strategy at the national and provincial level, with a view to identifying and strengthening sources of economic growth is also in the pipeline.
4. Moreover, technical cooperation operations are in preparation that aim to improve the competitiveness of small- and medium-sized enterprises and to strengthen the financial sector.
5. The Bank's new strategy for action in Argentina is expected to be prepared and discussed with the new government in 2003 and approved by early 2004.

Buenos Aires, Argentina
July 18, 2003

Mr. Horst Köhler
Managing Director
International Monetary Fund

Dear Mr. Köhler:

1. We have continued to pursue the implementation of our economic program and the economy continues to recover in conditions of broad price stability, with GDP growth for this year projected at 4½–5 percent. All end-June quantitative targets are expected to have been met. The monetary program remains firmly on track and the fiscal outturn—based on good performance in May—is expected to be well above the program target, with arrears on VAT refunds to exporters being reduced. In late June, we announced an important tax administration reform package to among other things combat tax evasion, increase penalties, and improve efficiency of tax collection. We are working with Congress to ensure the early approval of those measures requiring legislation. This package should help improve tax compliance and support our fiscal objectives for the second half of the year and beyond. In regard to 2003, we are committed to achieving the original program target of a consolidated primary surplus of 2.5 percent of GDP. The program for redemption of quasi-monies is also progressing well: a key step being the recent acceptance by Buenos Aires province for the redemption of *patacones* which comprise 60 percent of total quasi-monies remaining in circulation.
2. Progress is also being made with the structural agenda of the program. On public bank restructuring, we will launch in the coming days, in coordination with IDB, the bidding process for due diligence and strategic review of Banco Provincia based on agreed standards. As part of the review of the role of the public banks, we intend to resume discussions toward including Banco Ciudad in the process. In addition, amendments to the financial institutions law have now been approved by the Senate and are under consideration by the lower house (passage will be a structural benchmark for the last purchase under the arrangement). By end-July, we expect to announce a transitional capital requirement for banks' exposure to the public sector and interest rate risk. Finally, an agreement on a memorandum of understanding between the BCRA and the government regarding the transfer of realized central bank profits to the government is expected to be finalized before the Board meeting for the third review.
3. As we noted in the SMEP of June 13, 2003, we are committed to ending the stay on mortgage foreclosures at the end of its 90-day period. A mortgage registry has been established to identify debtors affected by the stay and we are developing alternative measures to assist poor debtors within existing budget constraints. In June, Congress approved legislation changing the foreign ownership rules and the application of the cramdown provision of the insolvency law for the media sector. No other provision of the insolvency law is affected and the government has no intention to expand to other sectors of the economy the treatment of the media sector under this law. A working group will be established by end-July to review by mid-October elements of the insolvency framework,

including those actions taken in respect of the media sector, with a view to ensuring that international best practices are maintained in this important area. On this basis, we request a waiver for the relevant continuous performance criterion under the Stand-By Arrangement.

4. In June, we held a number of meetings to continue the dialogue with external creditors in major financial centers, and we initiated the formation of creditor consultative groups in relevant markets. We continue to be in close contact with Paris Club creditors to resolve remaining issues regarding the coverage of debt and hope to sign an agreement with the Paris Club in the near future.

5. In view of the progress made under the program, we request the completion of the third review under the Stand-By Arrangement. As noted above, we foresee that June fiscal targets will be met. As full data would not be available by the time of the Board meeting, we request a waiver of applicability of the end-June fiscal performance criteria. Its observance and that of the continuous structural performance criteria will be conditions for the last purchase under the current arrangement.

6. Building on our meetings with you during your recent visit to Argentina, we have initiated discussions with Fund staff on a medium-term program and we hope that this can be finalized in August. It is our intention to maintain a close policy dialogue with the Fund in the period ahead.

Yours sincerely,

/s/

Dr. Roberto Lavagna
Minister of Economy

/s/

Lic. Alfonso Prat-Gay
President of the Central Bank

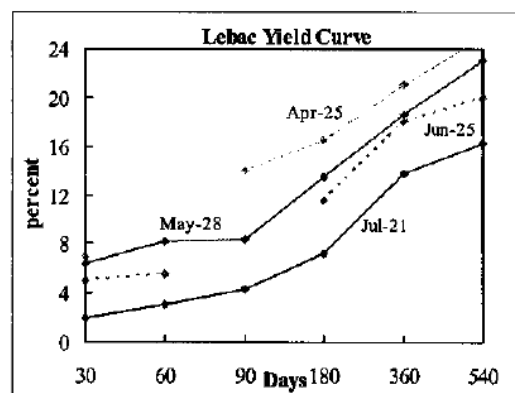
**Statement by the IMF Staff Representative
July 28, 2003**

1. The following information on recent developments and policy implementation has become available since the circulation of the staff paper on the third review under the Stand-By Arrangement (July 17, 2003). It does not alter the thrust of the appraisal.

I. ECONOMIC DEVELOPMENTS

2. Recent data indicate the following:

- **Market indicators remain firm.** In July, the peso has traded narrowly in the range of Arg\$2.78 to 2.82 per U.S. dollar; the central bank has made net purchases of US\$475 million so far in July; and gross international reserves stand at US\$12.3 million after a repurchase from the Fund of about US\$1 billion. Interest rates on central bank paper (*lebacs*) have fallen sharply, with 3- and 9-month rates down to 2 percent and 4¼ percent, respectively.
- **Economic activity has slowed but remains robust.** Monthly real GDP increased by 0.4 percent in May, bringing the 12-month rate to about 7 percent; the slowdown in activity to date has been evident mainly in industrial production (which accounts for about 15 percent of GDP).
- **Monetary data.** The end-June performance criteria on NIR and NDA were met with wide margins; base money exceeded the indicative target, fully reflecting unsterilized reserve accumulation. The stock of quasi-money has been reduced by a further Arg\$330 million so far in July, to Arg\$4.8 billion (from a peak of Arg\$7.5 billion).



| Program Monetary Targets, end June 2003 1/ | | | |
|--|--------|--------------------|--------|
| | Target | Adjusted target 2/ | Actual |
| NIR (US\$ mn) (floor) | -2,250 | -4,191 | -1,812 |
| NDA (Arg\$ mn) (ceiling) | 49,063 | 56,534 | 49,765 |
| Base money (Arg\$ mn) 3/ | 40,400 | 40,400 | 42,790 |

1/ Computed on the basis of a centered 21-day moving average.
2/ Adjusted for delays in programmed official financing.
3/ Includes federal and provincial quasi-monies.

II. POLICY IMPLEMENTATION

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

- **The bidding process to conduct a due diligence and strategic review of Banco Provincia was launched on July 20, 2003 (structural benchmark).** The review is to be carried out on the basis of both existing central bank regulations (with forbearance) and of future regulations when temporary forbearance is removed.
- **On July 24, the central bank specified transitional capital requirements for banks' exposure to the public sector and interest rate risk (structural benchmark).** The associated regulation is expected to be issued by end-July.
- **A memorandum of understanding between the central bank and ministry of economy on central bank profit transfers has been signed (structural benchmark).** The memorandum, which is in line with agreements reached with Fund staff, limits transfers to realized central bank profits.
- **The authorities are presently undertaking a series of meetings with consultative groups of bond holders.** The meetings are being held in Europe, the United States, and Japan.



Press Release No. 03/126
FOR IMMEDIATE RELEASE
July 28, 2003

International Monetary Fund
Washington, D.C. 20431 USA

**IMF Completes Third Review of Argentina's Stand-By Arrangement,
Approves US\$1.05 Billion Disbursement**

The Executive Board of the International Monetary Fund (IMF) today completed the third review of Argentina's performance under a seven-month, SDR 2.17 billion (about US\$3.04 billion) Stand-By Arrangement, which was approved on January 24, 2003 (see [Press Release No. 03/09](#)). The completion of this review enables the release of a further SDR 749 million (about US\$1.05 billion). The Executive Board also approved Argentina's request for a waiver of the relevant structural performance criterion and the applicability of fiscal quantitative performance criteria for end-June 2003.

Following the Executive Board's discussion on Argentina, Horst Köhler, Managing Director and Chairman, said:

"Argentina's recent macroeconomic performance continued to be favorable. Consumer confidence has risen, inflation has declined further, financial market indicators have strengthened, and the economic recovery has been encouraging. Under the new government, Argentina has continued to meet the fiscal and monetary targets of the transitional arrangement with comfortable margins.

"Fiscal policy has been overperforming and there is room to exceed the primary surplus target for 2003. The authorities are committed to maintain fiscal discipline, and have undertaken important tax administration reforms that will ease the transition to the higher fiscal savings that will be required over the medium term to restore solvency to the public finances.

"Given the absence of inflation pressures, a continued cautious expansion of base money appears appropriate. Nevertheless, the authorities need to remain vigilant to keep inflation in the low single-digit range.

"The work of the new government on the structural reform agenda needs to be accelerated in the period ahead. Sustaining growth over the medium term will require consistent implementation of a comprehensive structural reform program aimed, inter alia, at bank restructuring to restore financial intermediation, tax and intergovernmental relations reforms to achieve sustainable public finances, a framework for the adjustment of utility tariffs, and addressing poverty and

social issues. More effort will also have to be directed toward entrenching legal certainty, and respect for creditor rights.

“Medium-term prospects will hinge critically on public debt restructuring. It is important to continue to move the negotiating process with private creditors forward decisively.

“The IMF welcomes the authorities’ desire for a strong medium-term successor arrangement that would support higher sustainable growth and ensure the solvency of the public finances,” Mr. Köhler stated.

Statement by Guillermo Zoccali on Behalf of his Argentine Authorities
July 28, 2003

1. The well-focused staff report for the Third Review under Stand-by Arrangement confirms that **Argentina's economic situation and consumer and business confidence continue to improve**, in line with the Managing Director's expressions following his welcomed recent visit to Buenos Aires. My authorities are appreciative of the renewed effort of Fund Management and staff to help build on the progress made thus far.
2. The references in the report that the responsible conduct of macroeconomic policies has continued and that President Kirchner and cabinet members are intent on making fiscal discipline the hallmark of the new government, are accurate representations. **Regaining predictability while advancing social goals and delivering on their policy commitments, round out the new government's vision** and provide an encouraging basis for reaching understandings on a medium-term successor arrangement that could be supported by the Fund. To explain the new government's plan of action, President Kirchner has met in recent weeks with leaders of countries of the region, Europe and most recently the United States, including with representatives of the business and financial community.
3. My authorities have also expressed the **clear political will to make transparency a permanent policy** for building consensus. They view it as an important instrument for improving the functioning of institutions and the efficiency of the economic system, on the basis of clear and enforceable laws. In this light, they have indicated their consent to the publication of the staff paper in accordance with the Fund's policy on transparency.
4. Staff have adequately described in their report the conditions underlying the continuing economic recovery, the **over performance in the primary fiscal surplus**, the meeting of the quantitative performance criteria for net international reserves and net domestic assets with wide margins, and the expectation of a similar outcome for end-June on the basis of preliminary data.
5. Some additional observations might, nonetheless, be useful. **The more moderate pace of economic expansion follows an unsustainable annualized rate of growth** of 15.4 percent between October 2002 and April 2003, in the context of a declining but still sizable output gap and impaired access to new credit. In May, economic activity still grew by 0.4 percent over the preceding month and by 7.1 percent, year on year, despite small declines in industrial production. Record agricultural output and buoyant international prices underpinned a solid export performance. More recently, however, the decline in agricultural commodity prices and less favorable external demand conditions, in particular in the region, together with the continuing strong recovery in imports, in response to improving consumer confidence and renewed investment, put the moderating pace of activity and the expected drag of net exports on real growth in a more nuanced light.
6. The relatively **depressed nominal wages in both the formal and informal sectors of the economy**, contrast with the strong rebound in growth commented earlier and the

consequent productivity gains. While the generation of employment since last October constitutes a much welcomed development, the negative impact on the wage bill from the relative price realignment that followed the sharp depreciation of the exchange rate last year remained largely undiminished. This factor, together with the **still high level of unemployment** and the uncertainty regarding future income streams, may explain not only the low pass-through and subdued inflation, but also the **fragility of domestic demand, in particular of the most vulnerable groups**. In this context, my authorities announced the **first adjustment of the minimum wage in the last ten years**. The increase of Arg\$100 (equivalent to some \$35), to be phased in over the remainder of the year, is accompanied by a shift of other existing non-salary compensation into workers' base salary, implying higher taxable contributions. The net fiscal impact of these measures is deemed by my authorities small. Similarly, the 10 percent nominal increase in the minimum pension, benefiting some 1.1 million pensioners, that was also announced is estimated at around Arg\$500 million (equivalent to slightly over 0.1 percent of GDP). In sum, these measures partially compensate for the cumulative effect of the change in prices and in no way represent a departure from my authorities' prudent management of public expenditure.

7. The increase in international reserves of over \$2.6 billion during the first half of the year is considered in the report quite modest (although substantially higher than originally programmed). In July this trend has continued despite substantial net debt service payments to the IFIs, in particular to the World Bank, a further easing of foreign exchange controls on capital account transactions, and some appreciation of the nominal exchange rate. In addition, new, **partially unsterilized purchases of foreign exchange in July (of around \$1.1 billion) have been accompanied by record low interest rates for Central Bank Lebac** (1.99 and 2.99 percent p.a. for 35 and 63 day peso-denominated paper, respectively) amid strong demand from local investors. These aspects should serve to balance the signaling that may be derived from the reference in the report to continued net private capital outflows. Moreover, the figure given includes errors and omissions as well as service payments on some corporate external obligations and the accrual of arrears on debt in the process of restructuring. As to **the recent raising of the minimum maturity requirement on capital inflows from abroad**, this is aimed at averting a potential currency mismatch. My authorities view this as a **prudential norm** that responds to their concern over the volatility of short-term capital flows in the current circumstances of Argentina.

8. The staff recognition that the fiscal performance reflects **buoyant income tax collections and continued tight control over spending, should dispel concerns** raised during the Board's discussion on the second review of the SBA **that this outcome could be undermined by low inflation or was due to VAT arrears accumulation**. On this latter point, VAT refund arrears to exporters are being settled, according to my authorities' latest figures, at a pace of Arg\$350 million per month, except last May when refunds amounted to Arg\$500 million. The monthly refunds exceed the level of new claims by some Arg\$130 million. My authorities aim to extinguish carry-over VAT claims by September, settle outstanding "convergence factor" debt by November, and fully normalize the flow of VAT refunds to exporters' by May of next year. **The important tax administration reform package** aimed at improving tax compliance described by staff in paragraph 13 of the report, provides another indication of the intent of the new administration to bring about structural

fiscal change. It also represents a **major departure from the past practice of resort to tax amnesties to increase tax collection.**

9. The **provincial fiscal data confirm** continued adherence by the provinces to the bilateral fiscal consolidation agreements. Moreover, preliminary figures for the first semester indicate **over compliance in relation to the aggregate primary surplus target** of the provinces. On this basis, my authorities also expect to meet the program target for 2003. Since 2001, the fiscal consolidation effort by the provinces has exceeded 2 percent of GDP. This can be **attributable to the framework in place** for fiscal consolidation that includes conditionality on the provincial finances, as well as implementation of **orderly financing programs (PFOs), the exchange of provincial debts, and the redemption of provincial quasi-monies.** It is worth noting that the latter is progressing well and that the process of redemption is accelerating. It also represents an **important structural measure** that, together with the lifting of restrictions on frozen bank deposits and foreign exchange transactions, went **beyond the reform commitments envisaged in the transitional program.** The recent acceptance by the Province of Buenos Aires of the redemption of its Patacones together with simplified exchange channels, will give further impetus to this process, as these account for some 60 percent of total quasi-monies remaining in circulation.

10. Regarding the **structural benchmarks associated with the third review,** agreement has been reached between the Ministry of Economy and the central bank on a memorandum of understanding governing the **transfer of central bank profits,** as recommended in the Safeguards Assessment. In addition, approval by the central bank board is expected this Friday for the transitional **capital requirements for banks' exposure to the public sector and interest rate risk,** as envisaged. On the legislation amending the **Financial Institutions Law,** this was approved by the Senate and is awaiting passage into law after the Lower House reconvenes following its recess. My authorities consider that **this legislation will provide key protection for administrative acts** linked to the discharge of bank resolution responsibilities and, by extension, **offer adequate protection to the officials involved, in line with international best practices.** As a corollary, the notion of full protection, mentioned by staff in footnote 4 of the report, is not envisaged in the Argentine constitution as this would imply immunity from criminal prosecution. Similarly, such a broadening of civil immunities would also call for the modification of the civil code. Lastly, the bidding process for **due diligence and strategic review of both, Banco Nacion and Banco Provincia, the two largest public banks, has been set in motion** and generated substantial interest from both domestic and international consultants. Agreement on the terms of reference also required extensive consultation with the IFIs involved, which helps explain the delay noted in the report. Regarding the inclusion of Banco Ciudad, suffice it to note its much smaller size, the different balance sheet composition in relation to the other public banks, with a high proportion of performing consumer loans and stable depositor base and, as significantly, with no outstanding rediscounts from the central bank.

11. My authorities are intent on strengthening the predictability of the legal framework. In this regard, they are **committed to ending the temporary 90-day stay on mortgage foreclosures,** notwithstanding its limited macro-economic impact. A mortgage registry is being compiled to identify the full impact of the norm. Possible options that do not weaken

creditor rights or the fiscal situation are also being studied to mitigate the debt-service burden of poor debtors, recently heightened by the indexation modality applicable to bank loans and rents after pesification. Regarding the legislation enacted last June establishing a **limit on foreign ownership rules** and a change in the application of the **cramdown provision of the insolvency law for the media sector**, my authorities have noted that all the other provisions of the law, including in particular resort by creditors to liquidation, remain in full force. In addition, they have stressed that they have **no intention of extending this particular aspect of the law, linked to the cultural patrimony, to any other sector of the economy**. In the context of the continuous performance criteria under the program, a working group is being established to ensure that international best practices are maintained in this area.

12. **The rehabilitation of the banking system**, including the reversal of the massive contraction in lending to the private sector since 1998, and **the restructuring of the sovereign debt in arrears** figure prominently in my authorities' agenda to underpin confidence and sustain growth. In their efforts to move on these fronts, and tackle the difficult issue of the **privatized service utilities**, they have been mindful of the fiscal resource constraint. Similarly, while espousing adherence to international best practices, they have sought country-specific solutions attuned to the Argentine crisis, which was preceded by over four years of recession. The extent of the downsizing of the system from 170 to 90 banks following the Mexican crisis, and further cost-restructuring during the last three years, with the closing of 15 percent of bank branches, the shedding of more than 20 percent of bank jobs and the reduction of real wages in the sector by 45 percent should be kept in mind. My authorities consider that a significant part of the **problem is less related to the number of banks operating in the system and more to the reduced scale** as a consequence of depressed business conditions. In this light, their approach to restoring banking system profitability and capital augmentation has focused on continued prudent fiscal and monetary management, to sustain the declining interest rate environment and avoid the resurgence of inflationary pressures. At the same time, they have been advancing a sequenced implementation of prudential and institutional reforms that feeds on the recovery to improve soundness, while working with the Congress to unblock the sensitive issue of bank compensation.

13. The next steps toward a successor arrangement with the Fund, and the strategy for "normalizing" Argentina and its relations with the international community, include the broadening of structural reforms as well as **intense efforts to facilitate the dialogue with external creditors**. In this regard, **representative and respected regional consultative groups covering retail bondholders in Germany, Italy and Japan as well as international institutional creditors in New York are being formed**, to share ideas regarding possible debt exchange structures and instruments, provide early opportunity for feedback on restructuring design issues, assist in the communication with bondholders and advance Argentina's objective of equitable treatment among the different categories of creditors. The Secretary of Finance is currently on the road engaging such groups, including key representatives of the business and financial community with ties to Argentina, with this purpose. In addition, while a deferral agreement has not yet been signed with the Paris Club, my authorities are grateful for the good working relationship that has been established and remain committed to facilitating agreement on coverage.

14. In sum, **my authorities have welcomed the discussions with staff** in connection with this third review of the current Stand-by Arrangement and consider that the objectives of the program are being amply met. **The continued support of the Executive Board,** conclusion of the review and approval of the request for waiver of non-observance and applicability of performance criteria, **is seen as a critical step** along the path toward sustainability. **My authorities are anxious to move forward with scheduled discussions with staff on the development of a fully-owned, and realistically sequenced successor arrangement with the Fund** that supports the comprehensive adjustment and reform effort underway.