July 2004
IMF Country Report No. 04/195

Argentina: Second Review Under the Stand-By Arrangement and Requests for Modification and Waiver of Performance Criteria—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Argentina

In the context of the second review under the Stand-By Arrangement and requests for modification and waiver of performance criteria with Argentina, the following documents have been released and are included in this package:

- the staff report for the second review under the Stand-By Arrangement and requests for modification and waiver of performance criteria, prepared by a staff team of the IMF, following discussions that ended on **February 27, 2004,** 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 March 12, 2004**. 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 **March 22, 2004** updating information on recent developments.

- a Press Release summarizing the **views of the Executive Board as expressed during its March 22, 2004 discussion** of the staff report that completed the request and review.

- a statement by the Executive Director for Argentina.

The document listed below has been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Argentina*

*May also be included in Staff Report

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

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Price: $15.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

ARGENTINA

Second Review Under the Stand-By Arrangement and Requests for Modification and Waiver of Performance Criteria

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

Approved by John Dodsworth and G. Russell Kincaid

March 12, 2004

- **Stand-By Arrangement**. A three-year arrangement for almost SDR 9 billion (424 percent of quota) was approved by the Executive Board on September 20, 2003. In addition, repurchase expectations arising during the first year of the arrangement (about SDR 1.7 billion) were extended to an obligations basis. Cumulative purchases thus far amount to about SDR 2.1 billion (Tables 1 and 2). Completion of the second review would allow a purchase of SDR 2.1 billion.
- **Discussions**. Discussions were held in Buenos Aires during February 19–27, 2004 with Minister of Economy and Production Lavagna, Central Bank President Prat-Gay, and other senior officials and private sector representatives. The staff team comprised J. Thornton, A. Cebotari, L. Giorgianni, J. Nelmes, L. Ali (Assistant) (all WHD), A. Arvanitis (PDR), C. Blitzer and P. Breuer (ICM), and D. Lombardo (FAD). The discussions were led by J. Dodsworth, senior resident representative, and the mission was assisted by L. Cubeddu, resident representative. There was an overlapping MFD mission, led by Ms. Pazarbasioglu.
- **Political Developments**. President Kirchner continues to enjoy record levels of support. In a recent speech to open the new Congress, the President endorsed the Fund-supported program, pointed to the great effort that will be needed from the Argentine people to exit from default, and reminded creditors, including the IFIs, of their shared responsibility in the build up of Argentine debt.
- **Economic Developments**: The economy is recovering rapidly, while inflation remains subdued. Strengthening consumer and business confidence and cautious monetary and fiscal policies have facilitated further reductions in interest rates, a stable peso, and further reserve accumulation. Buoyant tax revenues resulted in larger-than-programmed fiscal savings in 2003.
- **Program Implementation**. Policies remain on track. All continuous structural performance criteria and end-December 2003 quantitative criteria were observed, with the exception of the continuous criterion on non-accumulation of arrears to bilateral and multilateral creditors, for which a waiver is requested (Box 1 and Table 3). The structural performance criterion on the ratification of federal-provincial bilateral agreements was met ahead of the end-March 2004 deadline, but there was a small delay in implementing the structural benchmark on reporting the findings of the working group on insolvency reforms (Box 2).
- **Letter of Intent** (LOI). In their March 10, 2004 LOI, the authorities have updated the macroeconomic framework and develop further their policy agenda for the remainder of the year, including for fiscal structural reforms and the banking strategy, and request a modification of the performance criterion associated with compensation payments to banks for asymmetric *pesoization* and indexation.
- **Financing Assurances**. In their LOI, the authorities commit to: (i) constructive negotiations with all representative creditor groups, including the Global Committee of Argentine Bondholders; (ii) issuance of a decree appointing investment banks as a prior action; and (iii) developing with their investment banks a framework to secure a collaborative agreement that will result in a comprehensive and sustainable debt restructuring.

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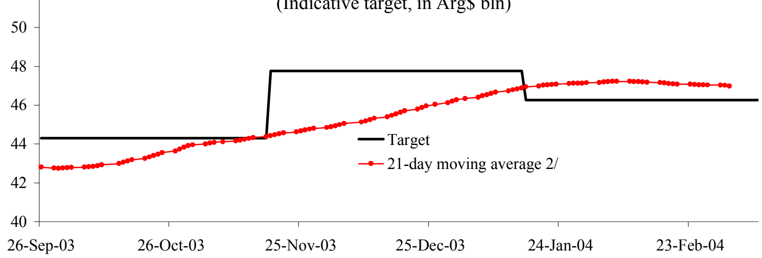
I. Recent Developments and Policy Implementation

1. **Economic growth continues to outpace expectations and inflation has slowed further** (Figures 1–2). Real GDP is estimated to have risen by 8.4 percent in 2003, driven both by strong private consumption and investment. Real wages and employment continue to recover—unemployment falling by about 2 percentage points (to 14.5 percent) in the final quarter of 2003—and consumer and business sentiment remain strong. Consumer price inflation slowed further (to 2.3 percent year-on-year) in February 2004, though wholesale and construction price inflation has begun to pick up.

2. **The external trade surplus is moderating, reflecting the continued strong recovery in imports**. While high commodity prices and strengthening partner country demand are pushing export receipts to record levels, imports also continue to surge, driven by buoyant economic activity. The current account remains in substantial—though narrowing—surplus. Capital flight appears to have moderated, while private external arrears continue to accumulate but at a slower pace.

3. **Monetary policy continues to facilitate interest rate reductions and increases in international reserves**. Interest rates on 30-day time deposits declined to about 2½ percent in February 2004, from almost 4 percent at end-2003. The *peso* continues to trade narrowly at around 2.9 per U.S. dollar, while gross international reserves have risen further (by US$1 billion since end-2003) to US$15 billion (before the March 9 Fund repurchase) (Table 3). In the first quarter of the year, the central bank intensified its purchases of foreign exchange, which, despite increased sterilization efforts, has resulted in a higher path of base money than programmed (Text Figure). All the Arg$7¾ billion of quasi-monies that were issued during the crisis have now been taken out of circulation.

Text Figure: Augmented Base Money 1/
(Indicative target, in Arg$ bln)



1/ Monetary base plus federal and provincial quasi-monies in circulation.
2/ Measured at the average value over the ten working days preceeding the test date and the ten working day following the test date.

4. **The banking system is gradually returning to profitability, but balance sheets remain weak** (Box 3). In the final quarter of 2003, the banking system recorded average monthly profits of Arg$38 million, after losses averaging Arg$548 million per month in the year to September. The improvement in financial condition mainly reflects the decline in deposit rates, lower administrative costs, and reduced need for provisions Private deposits—mainly sight deposits—continue to rise strongly, despite sharply lower deposit rates. There are signs of a recovery in consumer credit.

5. **Fiscal performance continues to exceed expectations owing to buoyant tax revenues**. The consolidated primary surplus in 2003 was 3 percent of GDP—½ percent

above target—largely on account of higher-than-expected revenues from the income and foreign trade taxes, and a better-than-expected outcome at the provincial level. Tax collections in the first two months of 2004 were also substantially above the program target. As reported at the time of the first review, arrears on VAT refunds to exporters were eliminated well ahead of the end-March target date (structural benchmark), while the end-March 2004 structural performance criterion on the ratification of the 2004 provincial bilateral agreements by provinces representing over 100 percent of the 2002 deficit was met ahead of schedule.[1]

6. **As regards public debt restructuring**, **the authorities have selected three international investment banks and three domestic banks to assist in the debt exchange offer**. The terms of engagement of the banks are expected to be made public on March 15, with the issuance of a Presidential decree ratifying their appointment (prior action for Board consideration of the second review).

7. **Certain of Argentina's external private creditors and creditor representatives have established a representative committee**. The Global Committee of Argentina Bondholders (GCAB) was established on January 12, 2004 comprising representatives of non-Argentine institutional creditors and retail creditors mainly in Italy, Germany, Switzerland and Japan. The government has invited the GCAB and other creditor groups and creditor representatives to Buenos Aires to begin constructive negotiations (¶25 below).

8. **The government has announced increases in electricity and natural gas tariffs charged to large industrial and commercial users of between 10–35 percent**. Tariffs for liquid gas used in passenger transportation will also be raised. The increase in electricity tariffs is expected to take place shortly and will be retroactive from February 1, 2004. The increase for gas is expected to be implemented by end–May, following public hearings. The impact on inflation is estimated to be about one-half of a percentage point in 2004.

9. **Congress has recently approved legislation that reverses aspects of the labor reforms enacted in 2000**. The legislation is likely to discourage temporary employment contracts by reducing the employment test period. It also allows more centralized collective bargaining but limits tax incentives for employment to small and medium-sized enterprises.

[1] By early March 2004, 7 provinces (representing 113 percent of the 2002 deficit) had ratified their bilateral agreements out of 12 provinces that had signed agreements with the federal government.

II. Report on the Discussions

A. Macroeconomic Framework

10. **The macroeconomic framework has been updated to reflect the robust recovery** (Table 4 and Text Table A). Real GDP is now expected to expand by 5½ percent in 2004 (against 4 percent in the original program and a market consensus of 6.2 percent), driven mainly by strong domestic demand. Private consumption and investment are projected to grow strongly in response to higher real incomes and employment levels, continued low interest rates, and favorable external conditions. With respect to the balance of payments outlook, the authorities indicated that they expect both the current and capital account projections for 2004 to be broadly unchanged from the original program (Tables 5–6). The staff's view is that, with sustained policies, a higher reserves target could be feasible, especially given the sizable buildup of reserves so far in 2004. In light of considerable uncertainties, including particularly the unresolved sovereign debt, it was agreed to reassess the external projections at the next program review.

Text Table A. Macroeconomic Framework, 2003-04

	2003	2004	
	Estimate	Original	Revised
Real GDP growth, percent	8.4	4.0	5.5
Inflation (e.o.p.), percent	3.7	10.5	7-11
Current account balance, percent of GDP	5.9	5.0	4.8
Gross international reserves, billions US$	14.1	15.7	16.2

11. **The program band of 7–11 percent for inflation has been maintained**. The authorities expect inflation to rise from its current low level but to be contained within the lower end of the band (consistent with the February market consensus of 7.1 percent). They pointed out that, in addition to expected further adjustments in regulated prices, some pressures would likely emerge during the year from higher import prices and wage increases, especially in those sectors that have so far led the recovery. The staff pointed out that it would be more appropriate to aim monetary policy at lowering core inflation and avoiding second-round effects from utility tariff increases that are desirable in their own right.

B. Fiscal, Monetary, and Exchange Rate Policies

12. **Discussions on the fiscal situation centered on the authorities' response to a likely revenue over performance in 2004** (Tables 7–9). Consolidated revenues are expected to overperform by about 2 percent of GDP, reflecting both the stronger economic recovery and more determined efforts to reduce tax evasion (Box 4). The authorities' initial response is that the fiscal policy stance reflected in the recently approved 2004 budget remains appropriate and that they would maintain the consolidated primary surplus target of 3 percent of GDP for 2004.

13. **The authorities intend to use the additional revenues to cut taxes and make room for increases in spending** (Text Table B). The authorities have not yet decided on the mix and details of the tax measures. The staff encouraged them to reduce significantly the financial transactions tax as quickly as possible, given its highly distortionary effects on financial intermediation and the need to further strengthen the banking system. The authorities indicated that they will begin reducing the financial transactions tax from mid-2004, in line with program commitments, and that they may also introduce tax incentives for investment. Staff stressed that, to maximize their impact, the incentives should be temporary and aimed at new investment. On the expenditure side, a substantial portion of additional revenues would be automatically transferred to the provinces under the revenue-sharing arrangements. The staff stressed the importance of monitoring closely the quality of the resulting expenditures and that every effort should be made to accord priority to well-targeted social programs. The authorities agreed to reassess the scope and timing of the tax measures and spending initiatives at the next program review. At that time, discussions would also revisit the likely extent of overperformance and the overall fiscal targets for 2004.

Text Table B. Projected Allocation of the Revenue Overperformance

	In Billions of Arg$	In Percent of 2004 GDP
Projected revenue overperformance	**8.8**	**2.1**
A. Federal government	3.7	0.9
Tax Measures (incl. FTT reductions)	1.8	0.4
Increased spending 1/	2.0	0.5
B. Provinces (increased spending) 2/	4.6	1.1
C. Higher nominal primary balance	0.5	0.1

1/ Minimum pensions, reduction in arrears, and discretionary transfers to provinces for the homogenization of social security systems.
2/ Including for capital and social spending.

14. **Progress is being made, as envisaged in the original program, to further develop the agenda for intergovernmental fiscal reforms**. New fiscal responsibility and coparticipation laws have been drafted and will be made available to staff in late-March. Reforms in these areas are expected to strengthen fiscal discipline at the provincial level, improve incentives for provinces to raise revenues, and ensure a more equitable distribution of federal transfers (Box 5).[2] A reform blueprint—which has yet to be shared fully with the staff—will be discussed shortly with provincial governors in order to secure formal agreement on its main elements by end-March 2004 (a structural performance criterion). Legislation is expected to be submitted to Congress by end-May 2004 and ratification by federal and provincial legislatures is expected by end-August 2004.

15. **Other structural fiscal measures are also progressing in line with the program timetable, though further detail is needed to assess their content**. In this regard, the authorities have proposed new structural conditionality through the third quarter of 2004 (Boxes 1 and 2):

[2] See IMF Country Report No. 03/392 for more detailed background to these reforms.

- *Tax administration reforms*. Building on the recent comprehensive measures to combat tax evasion, the authorities plan to launch by end-March 2004 another package of measures to strengthen provincial tax administration and further increase compliance on customs and social security obligations. The measures will include setting up a unified corporate register based on consistent use of a single taxpayer identification number, and harmonizing procedures for prosecuting customs evasion with those for general tax evasion.

- *Tax policy measures*. As noted above, the authorities plan to reduce the distortionary financial transactions tax from mid-2004, and will decide on the extent of the reduction at the next program review. At that time, understandings on other tax policy measures will also be reached, as envisaged in the September 10, 2003 MEFP.

- *Pension reform*. The authorities are continuing with preparatory technical work on pension reform, and the staff has encouraged them to solicit feedback on their work from the World Bank and other stakeholders. The authorities also indicated that they wish to complete the initial stage of the intergovernmental reform before initiating the pension reform, given that the revenue-sharing arrangements could have implications for financing the pension system. This will likely delay the submission of pension reform legislation until the second half of 2004.

- *Expenditure management*. The authorities will request technical assistance from the Fund to strengthen provincial expenditure management systems and launch an integrated financial management information system in two pilot provinces.

16. **Monetary policy will aim at an inflation rate at the lower end of the program band**. The authorities viewed the recent pickup in base money (relative to program) as being anchored in a further strengthening of money demand, given the continued decline in inflation, reduction in interest rates, deposit growth, and reserve accumulation. Against this backdrop, they saw room for some easing of base money targets in the second half of the year. At this stage, it was agreed to wait until the third review to revise the program targets, including for international reserves, when more information would be available on the external outlook and any potential inflation risks (Table 10).

17. **With regard to reforms of the central bank institutional framework:**

- *As envisaged, the authorities expect to finalize preliminary recommendations on reforms to its charter by end-March 2004*. The recommendations will be issued for comments from a wider audience, including academics and the bankers' associations, with a view to preparing legislative amendments by end-September 2004. While the staff would have preferred keeping the original timetable for reforms in this area—with submission to Congress of amendments by mid-2004—the authorities explained that it was important to proceed cautiously to ensure that broad-based consensus was achieved, ahead of any commitment to a precise legislative initiative.

- *An updated safeguards assessment found that the central bank has made progress in reducing operational risks*. The central bank plans to address remaining weaknesses by further strengthening internal audit and financial reporting systems. Although the assessment recommended publication of audited annual financial statements based on International Financial Reporting Standards (IFRS), the authorities have so far agreed to provide the central bank's end-2003 financial statements in accordance with IFRS to Fund staff.

C. Banking System Policies

18. **With the financial condition of the banking system stabilizing, the central bank is now focusing on strengthening individual banks**. This process will continue to be driven by regular submission and analysis of bank business plans and cash flow projections, in the context of a gradual tightening of prudential requirements and strengthened supervision. In this regard, the authorities agreed to an ambitious timetable for the submission of three-year business plans by all banks (due by end-March 2004) and to reach agreement with all banks on strategies to ensure the viability of their operations (by June 2004).

19. **The central bank is making progress in strengthening bank supervision**. Financial reporting obligations by all banks have now been fully reinstated. In line with program commitments, the capital adequacy regime was reintroduced in January 2004 requiring banks to build gradually an adequate capital cushion against exposure to the public sector and interest rate risk. In addition, the central bank intends to undertake an intensive program of full-fledged on-site inspections for all banks during the remainder of 2004.

20. **However, there have been further slippages in finalizing bank compensation because of technical and administrative delays** and the authorities have requested that the associated end-March 2004 performance criterion be reset to end-June 2004.

- *As regards asymmetric pesoization*, the central bank has completed its verification process and concluded that banks had overestimated compensation due by about Arg$4½ billion—which will need to be written off from bank balance sheets. The banks will take ownership of the bonds (now held in escrow accounts) to cover the verified amount of compensation (Arg$28¼ billion) by end-June 2004.

- *In the case of asymmetric indexation,* compensation will be delayed to the second quarter, because of the delays in issuing implementing regulations and the complexity of the verification process involved. The authorities explained that the link between compensation and lending envisaged in the law authorizing compensation is a very liberal one, as the stock of eligible loans (including refinanced loans) is already larger than the estimated compensation due. The latter is in the order of Arg$1½–2 billion, out of an approved ceiling of Arg$2.8 billion.

21. **Following recent delays, a timetable for the strategic review of the two largest public banks has been agreed**.[3] New bids were launched on February 27, 2004 on agreed terms of reference for the selection of the financial advisors to conduct due diligence and strategic reviews of *Banco Nacion* and *Banco Provincia*. To guide the process forward, performance criteria are proposed for selection of the advisors (end-June 2004) and preparation of time-bound action plans for strengthening the banks (end-December 2004).[4] Meanwhile, all public banks continue to participate in the diagnostic exercises conducted by the central bank, including the submission of annual and multiyear business plans.

D. Corporate Restructuring and Utility Reforms

22. **Progress is being made in private corporate debt restructuring, within a broadly acceptable legal and regulatory framework**. The survey of private debt restructuring recently completed by the authorities suggests that the market-based and voluntary framework for private debt restructuring adopted under the program is producing good results: about 27 percent of the debt of the companies surveyed (accounting for over US$29 billion, or about 60 percent of Argentina's estimated total private corporate debt) and identified to be in need of restructuring have completed negotiations with their creditors. In a number of cases, restructurings are being completed under the pre-packaged bankruptcy procedure (a relatively new feature of Argentina's insolvency system), which allows a court to bind dissenting unsecured creditors to a restructuring plan approved by the requisite majority of creditors. Related to this, a working group charged with reviewing the legal framework for corporate debt restructuring has completed its work and concluded that the current insolvency system is being adequately supportive of restructurings.[5] The main corporates where restructuring has still to make progress are the utility/public service companies where tariff and regulatory framework issues remain outstanding.

23. **The financial situation of some utility companies is improving, but progress in the renegotiation of concessions has been uneven**. Interim agreements on utility tariffs and other revenue-enhancing measures have been reached in most transport concessions, including ports and airports where tariffs have been partially redollarized (Box 6). The announced adjustments in electricity and gas tariffs charged to large commercial users will primarily help nonregulated utility companies. However, tariff increases for regulatory companies have yet to be initiated. The preliminary findings and recommendations of the

[3] As reported in IMF Country Report No. 03/392, the delays reflected difficulties in the procurement process for funding the due diligence and strategic review of the banks.

[4] The selection of advisors was originally an end-April 2004 structural benchmark.

[5] The report of the working group on the insolvency law was completed on February 25, 2004, resulting in a short delay from the associated end-January 2004 structural benchmark.

joint fact-finding Bank-Fund mission that was invited by the authorities to assess the situation of the utility companies are reported in Box 6. In particular, the mission found that the renegotiation of concessions has been hampered by uncertainty over the direction of the broader regulatory changes considered by the authorities. In addition, the World Bank has raised concerns over draft legislation on the regulatory framework. In response to these concerns, the authorities agreed to delay to the second half of 2004 the submission to Congress of new regulatory framework legislation, with a view to giving time to elicit comments from stakeholders and reassess the appropriate role of the government in investment decisions. The staff encouraged the authorities to work closely with the World Bank to develop adequate policies in this area.

E. Debt Restructuring Strategy and Financing Assurances

24. **The authorities are developing a framework for reaching a collaborative debt restructuring agreement with private creditors**. In their March 10, 2004 LOI, the authorities indicate that the main elements of their approach are to: (i) appoint and retain investment banks throughout the restructuring process—subject to them satisfying their contractual obligations—to assist in preparations and help market the debt exchange offer; (ii) engage in meaningful and constructive negotiations with all representative creditor groups; and (iii) formulate the offer so that it will result in a sustainable debt for Argentina and attain broad support from creditors. In implementing this framework, the authorities explained that they will rely on the advice and input from the investment banks.

25. **Consistent with this framework, the authorities have indicated their willingness to negotiate with private creditors with the aim of reaching a collaborative agreement**. In particular, they have committed to meaningful negotiations with all representative creditor groups, including with the GCAB. They believe that dealing constructively and transparently with representative creditor groups is necessary to generate a high participation in the debt exchange among a diverse creditor base. The authorities indicated also their willingness to discuss all aspects of the debt exchange offer with creditors and taking into account the need to ensure debt sustainability, and to consider proposals received from them in formulating an eventual offer. Towards this end, the authorities have set in train the following process and timetable for engaging with creditors:

- *On March 9, 2004*, as a first step, the authorities invited 21 representatives of creditors, including the GCAB, to hold separate discussions in Buenos Aires during March 24–April 16, 2004.

- *By mid-April 2004*, they will seek to reach agreement with creditors on a follow-up process and timetable for negotiations.

26. **The authorities have indicated that they will decide on the features of the debt exchange offer and its timing following additional discussions with the investment banks and negotiation with creditors**. They are cognizant of the need to mobilize broad

creditor support and will seek to avoid a piecemeal approach to the restructuring. In this regard, the authorities would finalize with the assistance of their banks an appropriate minimum participation threshold in the eventual debt offer to obtain a broadly supported restructuring. The authorities reiterated their commitment to the principle of inter-creditor equity, though they noted the difficulty in applying this principle where some creditors have already experienced a previous restructuring of their claims. Given the need for consultations with the investment banks and additional discussions with creditors, the authorities believe that the exchange offer would not be launched before June 2004. At the same time, to avoid further delays, they expect to launch their offer not later than August 2004.

27. **Progress needs to be accelerated toward initiating discussions with Paris Club creditors**. The authorities are expected to write formally to the Paris Club Secretariat by mid-March 2004 indicating their request for the scope and type of treatment being sought on their bilateral debt.

III. Program Monitoring

28. **All quantitative and structural performance criteria for the second review were observed, except for the continuous criterion on the nonaccumulation of arrears to multilateral and bilateral creditors** (Table 3 and Box 1). The latter breach occurred following a short delay in completing part of a Fund repurchase. Staff reports a waiver for this breach on the basis that it was temporary. The end-December 2003 ceiling on the federal debt, which was the only applicable end-period quantitative performance criterion for this review, was met by a margin of Arg$2 billion (Table 11).[6] The end-December 2003 indicative targets on the consolidated public sector debt and on the primary surplus for provincial governments were also observed. As regards structural conditionality, the performance criterion on the ratification of the 2004 federal-provincial bilateral agreements and the structural benchmark on the elimination of VAT arrears to exporters were met well ahead of the end-March 2004 deadlines. However, two structural benchmarks (on reporting of provincial financing data within 55 days of end-December 2003 and on the preparation of a report on Insolvency Law reform by end-January 2004) were implemented with minor delays (Box 2).

29. **The new program conditionality through the third quarter of 2004 is as follows**: (i) the program's end-September 2004 indicative targets on the federal government debt and the BCRA's net international reserves and net domestic assets are proposed to be converted to performance criteria; and (ii) the end-September 2004 floor for the federal primary surplus is proposed to be converted to a performance criterion and revised upward slightly, in line with the higher-than-programmed nominal GDP. The authorities also requested the resetting

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[6] Compliance with the other fiscal and monetary end-December 2003 performance criteria was reported at the time of the first review.

of the performance criterion on finalizing bank compensation for asymmetric *pesoization* and indexation to end-June 2004, from end-March 2004. Additional structural performance criteria and benchmarks are proposed to be set with a view to monitoring the implementation of key program actions, including on reforms of intergovernmental relations, further strengthening of tax administration, the strategic review of the two largest public banks, and the implementation of multi-year business plans by all banks (Boxes 1 and 2).

IV. Staff Appraisal

30. **The continued implementation of cautious macroeconomic policies has been key to keeping the recovery on track with low inflation**. Fiscal performance in 2003 was especially commendable, as the authorities were able to markedly step up tax collections and maintain spending discipline and, thereby, far exceed their original primary surplus target. In addition, monetary policy has been restrained enabling reduced interest rates, a stable peso, and a further accumulation of reserves. These policies, combined with favorable political developments, have bolstered consumer and business confidence and provided a foundation for a broad-based recovery in domestic demand. The continuation of disciplined macroeconomic policies is an essential ingredient to ensure the durability of the recovery and set Argentina on a sustainable path of medium term growth and poverty reduction.

31. **Strong budgetary performance provides a crucial opportunity for locking in an ambitious fiscal consolidation path and moving ahead forcefully with the debt negotiations**. While the staff argue that it is early in the fiscal year to firmly revise the budget, revenue overperformance could be significant and due consideration should be given to the best way of utilizing additional resources, including by increasing government savings. An early and significant reduction in the financial transactions tax should also be a priority given the need to strengthen the banking system, while other tax cuts could also be considered, if they are part of a well articulated tax policy reform. Some additional revenues will automatically be transferred to provincial governments, and spending by the provinces needs to be closely monitored to ensure the additional resources are used efficiently for well-targeted social and public investment programs. In any budget revision, the authorities need to bear in mind that, as committed to in the original letter of intent, an upward trend in the primary surplus will be required over the medium term to ensure fiscal sustainability. In this regard, the overall fiscal targets for 2004 will be discussed at the time of the next program review.

32. **Structural fiscal reforms, which are being developed in line with the program timetable, face crucial tests of political acceptance and implementation in the period ahead**. The authorities have made good progress in combating tax evasion, and are expected soon to take further important steps to improve social security and customs administration. In addition, progress is expected towards securing a political consensus for the new fiscal responsibility and coparticipation legislation. These are critical initiatives and the authorities need to ensure that the reforms that will be proposed to Congress provide a durable solution for the weaknesses of the current system—namely insufficient control over provincial

finances, lack of incentives to raise own revenues at both levels of government, and a lack of equity in the distribution of resources among the provinces.

33. **Monetary policy needs to take into account the narrowing output gap and anticipated utility tariff increases, which could fuel a rise in inflation expectations**. A number of factors point to the potential for inflation to rise somewhat from its current moderate rate. Thus, while the program target band of 7–11 percent remains comfortably within reach, monetary policy will have to be set carefully so as to maintain low inflation expectations in the presence of sectoral wage hikes and increases in headline inflation due to one-off adjustments in regulated prices. At the next review, an assessment will be made of the potential for easing the program path for base money and adopting a more ambitious target for international reserves taking into account inflation and wage developments, and the external outlook.

34. **While financial conditions in the banking system are improving, close central bank supervision is needed given continuing weaknesses in balance sheets**. The banking system is gradually returning to overall profitability, though many banks still remain vulnerable to interest rate increases and the system as a whole will take some time to rebuild adequate capital. The reintroduction of a capital adequacy regime in January was an important milestone and the central bank appears to be enhancing its supervisory control through banks' business plans and on-site inspections. The repeated delays in moving ahead with pending bank compensation and with the due diligence and strategic reviews of the two main public banks are highly regrettable. It is hoped that the authorities will quickly complete the bank compensation and implement the newly agreed schedule for reform in this area in a timely fashion.

35. **Private corporate debt restructuring is an essential element for restarting credit flows and supporting growth**. The substantial progress reported in the debt restructuring of the major corporates is a welcome sign and gives support to the authorities' strategy of relying on a purely market-based framework. Given this progress, it will be important for the authorities to continue to resist pressures for any amendments to the bankruptcy law that would weaken creditors' rights.

36. **The authorities are beginning to tackle the problems of the utility companies, but much still remains to be done.** Additional efforts are needed both to strengthen the financial position of utility companies and to provide greater certainty about the future environment in which they will operate. While the initiation of electricity and gas tariff increases for large users is a welcome step, the authorities should follow on with tariff adjustments also for the regulated concessionaires so as to help restore their viability. The authorities are also urged to work closely with the World Bank to develop a balanced regulatory framework that would help accelerate the process of renegotiation of concessions, attract new private investment into the sector, protect low income households, and allow utilities to restructure their debts.

37. **The authorities' willingness to negotiate with private creditors is key to reaching a collaborative agreement on a comprehensive restructuring**. It is particularly encouraging that the authorities are entering into constructive negotiations with all representative creditor groups and have sent letters to them, including the GCAB. The framework for engaging creditors that the authorities will develop with the assistance of the investment banks should provide the basis for developing proposals and counter-proposals. Much will depend on the adoption of an open attitude by both sides in the initial rounds of meetings with creditor groups that are to be scheduled during March 24–April 16.

38. **The avoidance of a piecemeal approach to the debt restructuring is essential to regularize relations with creditors, stem litigation risks, allow responsible reaccess to capital markets, and safeguard Fund resources**. The inclusion of a minimum participation threshold for the completion of the exchange offer—by bolstering creditors' incentives to participate in the exchange—appears the best way to avoid a piecemeal outcome. Importantly, the authorities have committed to consult with the investment bank advisors on the appropriate minimum participation threshold necessary for broad creditor support. Progress in these consultations will be discussed in the context of next financing assurances review.

39. **Staff recommends the completion of the second review under the program and of the financing assurances review—**in view of the continuing progress in meeting the programs targets and objectives, the authorities' renewed commitments to the program as exemplified in their March 10, 2004 letter of intent, and the authorities' proposals for more constructive engagement and meaningful negotiations with creditors. Staff also supports the requested modification of the structural performance criterion relating to completion of bank compensation and a waiver for temporary nonobservance of the continuous performance criterion on nonaccumulation of arrears to bilateral and multilateral creditors.

Box 1. Current and Proposed Structural Performance Criteria: March 2003–December 2004

I. Current Performance Criteria	
Continuous performance criteria	
• Nonaccumulation of arrears to bilateral and multilateral creditors.	Not observed
• No new tax amnesties (MEFP ¶29). 1/	Observed
• No statute or other legal instrument will be adopted that provides a means for any involuntary suspension or other restraint of creditors rights (MEFP ¶50).	Observed
End-March 2004	
• The federal government and a critical mass of provincial governors to reach agreement on the principles for intergovernmental reform and fiscal responsibility legislation (MEFP ¶31)	Pending
• Federal-provincial bilateral agreements shall become effective through their ratification by the provincial legislatures representing at least 100 percent of 2002 consolidated provincial deficit (MEFP ¶17).	Observed
• Finalize the compensation to banks for losses associated with asymmetric *pesoization* and indexation (MEFP ¶12).	Proposed to be reset to end-June 2004
II. Proposed Performance Criteria	
End-May 2004	
• Submit intergovernmental reform and fiscal responsibility legislation to Congress (MEFP ¶31)	
End-June 2004	
• Finalize the compensation to banks for losses associated with asymmetric *pesoization* and indexation (MEFP ¶12)	Proposed to be reset from end-March 2004
• Complete selection of accounting and consulting firms to begin the strategic review of the two largest public banks (MEFP ¶38)	
End-August 2004	
• Federal and provincial legislatures to ratify the intergovernmental reform and fiscal responsibility legislation (MEFP ¶31)	
End-September 2004	
• Submit to Congress the 2005 budget consistent with the program targets for 2005 (MEFP ¶8)	
• Submit tax reform legislation to Congress consistent with earlier commitments (MEFP ¶28)	
End-December 2004	
• Finalize a time-bound action plan for strengthening the two public banks (MEFP ¶38)	

1/ Refers to commitments described in the MEFP dated September 10, 2003.

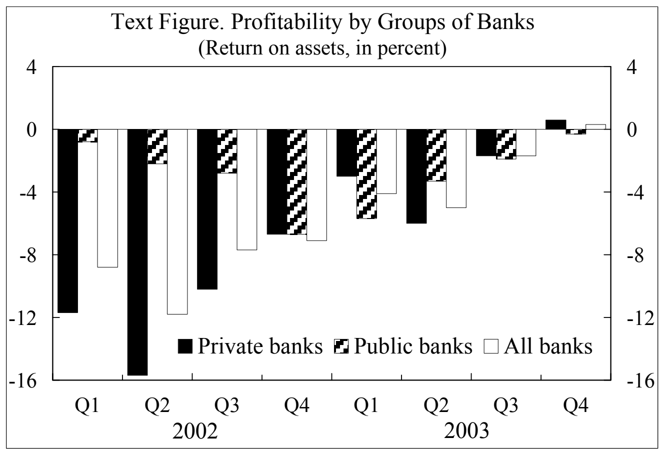
Box 2. Current and Proposed Structural Benchmarks: March 2003–December 2004

I. Current Structural Benchmarks	
Continuous structural benchmarks	
• Provide Fund staff with monthly information on provincial government financing with a delay of less than 55 days	December data reported with a one-day delay
End-January 2004	
• Report of working group on Insolvency Law reform (MEFP ¶48) 1/	Report submitted on February 25, 2004
End-March 2004	
• Working group charged with the design of reforms of the central bank charter to publish report containing its key findings and recommendations (MEFP ¶34).	Pending
• Launch of second tax administration reform focusing on improving customs administration and social security collections (MEFP ¶29).	Pending
• Elimination of arrears on VAT refunds to exporters (MEFP ¶13).	Arrears eliminated by end-November 2003
II. Proposed Structural Benchmarks	
End-June 2004	
• BCRA to reach agreement on mutually acceptable business plans with all banks (MEFP ¶42 and January 9, 2004 LOI, p.3)	
• BCRA to begin providing the Fund with annual financial statements in accordance with International Financial Reporting Standards, commencing with the end-December 2003 financial year (MEFP ¶54)	

1/ Refers to the MEFP dated September 10, 2003.

Box 3. An Update on the Financial Condition of the Banking System 1/

The financial condition of the banking system had stabilized by end-2003 and the system as a whole is expected to record positive operating returns during 2004: banks remain very liquid (liquid assets are about 14 percent of total assets); deposits continue to grow (by 21 percent in 2003 and a further 3½ percent in the first two months of 2004), although growth is largely restricted to sight deposits; and credit expansion to the consumer sector is showing signs of recovery. Key recent developments include:



- **Profitability**. Average monthly losses declined from Arg$670 million in the first half of 2003 to Arg$180 million during the second half, mainly reflecting the sharp decline in interest rates and steps to reduce administrative costs. In December 2003, the banking system as a whole recorded monthly profits of Arg$410 million, with the improvement taking place mainly in private banks (Text Figure).

- **Asymmetric *pesoization***. The banks claimed compensation for Arg$33 billion, which they had already recorded as an asset in their balance sheets. Following on-site audits of the bank, the central bank verified claims for about Arg$28½ billion, and the banks will have to write off the difference from the balance sheets in the course of 2004. The foreign, domestic, and public banks account for about Arg$2 billion, Arg$1.4 billion and Arg$1.2 billion of the lost claims, respectively. The compensation payments—in the form of government bonds (Boden 07 and Boden 12 bonds)—were placed in advance in escrow accounts, and the banks will now assume ownership of them.

- **Asymmetric indexation**. As the increase in the wage index (CVS) since early 2003 has been much greater than that of the price index (CER), the fiscal cost of the compensation for the asymmetric indexation of loans is now estimated to be about Arg$1.6 billion compared to the initial estimate of Arg$2.8 billion that was approved by the Congress.

- **Net worth**. Adjusting the balance sheets of the banks for the elimination of the overestimation of compensation for asymmetric *pesoization* and the compensation for asymmetric indexation, the net worth of the banks declines from Arg$23.1 billion (12.2 percent of assets) to Arg$20.1 billion (10.7 percent of assets). An immediate write-off of *amparos* would imply a further decline in net worth to Arg$13.9 billion (7.4 percent of assets).

1/ Prepared by Ceyla Pazarbasioglu and Jorge Cayazzo (both MFD).

Box 4. Federal Tax Revenue Overperformance[1]

Tax revenues increased sharply in 2003, substantially overperforming compared to the program, and are likely to continue to overperform in 2004.

- **Tax revenue developments in 2003**. Federal tax revenues jumped by 42 percent (3.1 percentage points of GDP), largely reflecting higher-than-projected revenues from the income tax and VAT (Table 1). The overperformance relative to the program (Arg$2.9 billion or 0.8 percent of GDP) reflected:
    - *Higher-than-programmed economic activity*, which explains over 40 percent of the overperformance (Table 2).
    - *Higher-than-anticipated tax buoyancy*, especially of the income and trade taxes, in part reflecting new tax administration measures.
    - *One-off factors related* to recording revenues collected in quasi-monies (*patacones* and *lecops*), explaining about ¼ of the overperformance.

Table 1. Contributions to revenue growth (in percent)

	2002	2003	2004 Proj.
Total tax revenues	**10.6**	**42.0**	**24.0**
Traditional taxes, *of which:*	**-1.0**	**25.7**	**18.1**
Income tax	-2.5	11.1	7.1
VAT	-0.2	10.8	8.7
Extraordinary taxes	**14.5**	**9.9**	**2.5**
Financial transaction tax	4.0	2.0	1.5
Export tax	10.4	7.9	1.0
Other taxes	**-2.9**	**6.3**	**3.4**

- **2004 outlook.** Federal tax revenues are projected to remain buoyant, exceeding the original program projections by Arg$7.9 billion (2 percent of GDP). This reflects:
    - *Revisions to the macroeconomic framework*, which provide for higher growth in major tax bases (consumption, trade).
    - *Higher tax buoyancy*, reflected in the higher-than-anticipated 2003 tax receipts and the strong tax performance in the first months of 2004.
    - *Higher-than-projected corporate profits in 2003*. The recently published 2003 corporate income statements suggest record profits, particularly of oil producers and commodity exporters.

Table 2. Federal Tax Overperformance (estimates, in Arg$bn)

	2003	2004
Overall overperformance, due to:	**2.9**	**7.7**
Revised macro-framework	1.3	1.9
Higher tax buoyancy in 2003	0.8	4.0
Delayed registration of revenues	0.8	...
Recovery in corporate profits	...	1.8

[1] The analysis is based on a different revenue classification than presented in the summary federal government operations (see Table 8).

Box 5. Status of Proposals to Reform of Intergovernmental Relations[1]

- **The authorities are close to reaching agreement with provincial governors on the main elements of intergovernmental reform, including on**: (i) fiscal responsibility that would aim to increase control over provincial borrowing; and (ii) a blueprint for simplifying the tax revenue-sharing arrangements, improving incentives to raise own revenues, and ensuring a more equitable distribution of transfers among provinces.

- **The proposed fiscal responsibility legislation would**: (i) establish deficit ceilings and debt limits (equal to 25 percent of revenues) for the provinces; (ii) subject provincial borrowing to federal government authorization (for the portion exceeding the debt limits, though authorization will always be required in the case of foreign currency debt); and (iii) establish incentives and financial penalties for noncompliance with these limits and procedures.

- **The proposed reforms with respect to revenue sharing are**:

  - *The revenue-sharing base would be the total of taxes currently "coparticipated," with a simple formula for allocating resources between the federal and provincial governments.* The shared tax base will exclude trade taxes (including the export tax) and 70 percent of the financial transactions tax, which will continue to accrue to the federal government. This tax base will be distributed as follows: 60 percent to the federal government and 40 percent to the provincial governments. The increased share going to the federal government would compensated for financing the operations of the pay-as-you-go component of the pension system.

  - *Revenue sharing would remain fixed up to the 2004 nominal allocation,*[2] *beyond which:* (i) a fixed nominal amount (still to be determined) would be transferred to a fund for federal spending on infrastructure and social spending in the poorer areas of the country—ten northern provinces and the metropolitan areas of Buenos Aires, Cordoba and Rosario; and (ii) remaining revenues would be distributed according to the 60-to-40 proportions specified above, but with 10 percent of the additional allocation to the provinces being distributed according to economic efficiency criteria, i.e., provinces would be rewarded for their relative improvements in own-tax collections, achieving targeted primary surpluses, and reducing their debt.

  - *A fiscal federal institution would be created* to make decisions with respect to future intergovernmental relations.

[1] The September 10, 2003, MEFP envisaged an intergovernmental reform that focused on: "the tax revenue sharing arrangements, the introduction of binding debt and deficit ceilings for provincial governments, reforms aimed at strengthening provincial revenue capabilities, and the creation of a fiscal federalism agency capable of guiding provincial future intergovernmental relations (MEFP ¶31)."

[2] The distribution among provinces would not change in the event that coparticipated taxes fall short of the 2004 levels.

Box 6. Utility Reform: Findings of the Joint WB/IMF Mission

- **The preliminary findings of the joint World Bank-Fund team that visited Buenos Aires in February 2004 to evaluate progress in the renegotiation of the public service and infrastructure companies were as follows**:
  - *The focus of the renegotiations has changed from agreeing interim adjustments to contracts to agreeing on long-term comprehensive contracts*. The authorities also wish to: (i) introduce a new regulatory framework to strengthen the role of government in the utilities sector; and (ii) ensure that the tariff structure includes a "social price" component for most utilities and explicit subsidies in the case of transport. The change in focus has slowed the renegotiation and introduced uncertainties about the future role of the private sector in utilities concessions.
  - *As of early-March, 48 out of 62 concessions remain to be renegotiated*. In October 2003, 13 inter-urban road contracts were allowed to expire, and new concessions were awarded under a new model of operation and management with government playing a prominent role in investment decisions. The authorities hope to finalize agreements with an additional 39 concessions by end-June 2004, and with the remaining concessions (telecommunications, passenger railways) by end-2004 (see Table).
  - *Most concessionaires are now running a cash-operating surplus*—reflecting the appreciation of the peso, and to a lesser extent the recovery in demand—but delays and uncertainties in the renegotiation have limited investment and are hampering the utilities' efforts to restructure their nonperforming debts (an increasing share of which is owned by vulture funds). In addition, the number of cases before the International Center for the Settlement of Investment Disputes (ICSID) has increased to 27.
  - *The announced utility tariff increases represent an important step towards restoring the viability of unregulated electricity and gas producers*. The measure, however, does not improve the finances of the 22 regulated concessions responsible for energy transport and distribution.
  - *A series of clearance procedures is required to give legal status to the agreements reached between the executive and concessionaires, including:* public hearings, reviews by control entities, and congressional ratification.
- **The key recommendation of the mission was to expedite the renegotiation process by**: (i) finalizing the reports on whether the utility companies have complied with their contractual obligations; (ii) establishing detailed week-by-week negotiation timetables; (iii) clarifying with concessionaires the regulatory impacts of the proposed renegotiation; and (iv) revising the proposed regulatory legislation in a manner consistent with the renegotiated contracts, and supportive of private sector participation, while seeking to protect low-income households.

Argentina. Status of Concession Renegotiation, March 2004

	Number of Contracts	Foreign Debt (US$ billion)	Ongoing Negotiations	Tariffs Adjusted/ Revenues Enhanced
Regulated concessions	**62**	**10.5**		
Energy 1/	**22**	**4.0**		
Electricity (transport and distribution)	11	1.4	√	
Gas (transport and distribution)	11	2.7	√	
Water 1/	**1**	**0.7**	√	
Telecommunications 1/ 2/ 3/	**2**	**5.0**		
Transport	**37**	**0.8**		
Urban access roads 2/	4	0.7	√	
Inter-urban roads	15		√	√
Freight railways	5		√	√
Passenger railways 3/	6		√	√
Ports	4		√	√
Airports	1	0.2	√	√
River toll	1		√	√
Bus terminal	1		√	…

1/ Concessions with majority of foreign shareholders.
2/ Commitment to finalize renegotiations for telecom and passenger railways by end-December 2004. All other concessions by end-June 2004.
3/ Debt restructuring agreement reached with one of the telecommunication companies (roughly US$1.8 billion).

Table 1. Argentina: Schedule of Purchases Under the SBA, 2003–06

	Purchases			
Date	In Millions of SDRs	In Percent of Quota	In Millions of U.S. dollars 1/	Conditions 2/
Scheduled purchases	8,981.0	424.2	13,315	
2003				
September 22, 2003	1,830.0	86.4	2,592	Disbursed upon Board approval of SBA
2004				
January 28, 2004	241.0	11.4	360	Disbursed upon Board approval of first review
March 15, 2004	2,100.0	99.2	3,150	Second review; end-December 2003 performance criteria
June 15, 2004	500.0	23.6	750	Third review; end-March 2004 performance criteria
September 15, 2004	740.0	35.0	1,110	Fourth review; end-June 2004 performance criteria
December 15, 2004	490.0	23.1	735	Fifth review; end-September 2004 performance criteria
2005				
March 15, 2005	532.5	25.2	798	Sixth review; end-December 2004 performance criteria
June 15, 2005	532.5	25.2	798	Seventh review; end-March 2005 performance criteria
September 15, 2005	532.5	25.2	798	Eighth review; end-June 2005 performance criteria
December 15, 2005	432.5	20.4	648	Ninth review; end-September 2005 performance criteria
2006				
March 15, 2006	366.7	17.3	551	Tenth review; end-December 2005 performance criteria
June 15, 2006	366.7	17.3	551	Eleventh review; end-March 2006 performance criteria
September 15, 2006	316.6	15.0	476	End-June 2006 performance criteria
Memorandum items:				
2003	1,830.0	86.4	2,592	
2004	4,071.0	192.3	6,105	
2005	2,030.0	95.9	3,042	
2006	1,050.0	49.6	1,577	
Quota	2,117.1	100.0	...	

1/ The figures in US dollars are for illustrative purposes. For past purchases, the US$/SDR used is of the day of the Board meeting. For future purchases, an exchange rate of US$1.5 per SDR is assumed for 2004, US$1.4986 per SDR for 2005 and US$ 1.5018 per SDR for 2006.

2/ All purchases are subject to adherence to the continuous performance criteria. In addition, and for the period that sovereign arrears to private external creditors persist, purchases will be subject to financing assurances reviews.

Table 2. Argentina: Net Debt Service to the IFIs, 2003–06
(In billions of U.S. dollars)

	2003					2006			Sep. 2003-
	Jan.-Aug.	Sep.-Dec.	Year	2004	2005	Jan.-Aug. 1/	Sep.-Dec.	Year	Aug. 2006 2/
IMF 3/									
A. Debt service	3.0	3.4	6.4	6.1	3.8	1.8	1.1	2.9	15.1
Principal 4/	2.5	3.2	5.7	5.6	3.2	1.2	0.8	2.1	13.2
Interest	0.5	0.2	0.7	0.5	0.6	0.6	0.2	0.8	1.9
B. Disbursements	3.0	2.6	5.6	6.1	3.0	1.6	0.0	1.6	13.3
C. Net debt service (A-B)	0.0	0.9	0.8	0.0	0.8	0.2	1.1	1.3	1.9
D. Credit outstanding	15.2	15.5	15.5	16.1	15.9	16.3	15.4	15.4	
World Bank									
A. Debt service	2.1	1.2	3.3	1.1	1.3	1.0	0.5	1.5	4.6
Principal	1.1	1.1	2.2	0.8	0.9	0.7	0.4	1.1	3.5
Interest	0.2	0.1	0.4	0.3	0.4	0.3	0.2	0.5	1.1
Arrears clearance	0.8	0.0	0.8	0.0	0.0	0.0	0.0	0.0	0.0
B. Disbursements	1.3	0.7	1.9	1.2	0.9	0.7	0.4	1.1	3.5
C. Net debt service (A-B)	0.9	0.5	1.4	-0.1	0.4	0.3	0.2	0.5	1.1
D. Credit outstanding	7.9	7.5	7.5	7.9	7.9	7.9	7.9	7.9	
IDB									
A. Debt service	2.0	1.0	3.0	0.9	1.1	1.2	0.6	1.8	4.2
Principal	0.8	0.8	1.7	0.4	0.6	0.9	0.4	1.3	2.7
Interest	0.4	0.2	0.6	0.5	0.5	0.3	0.2	0.5	1.5
Arrears clearance	0.7	0.0	0.7	0.0	0.0	0.0	0.0	0.0	0.0
B. Disbursements	1.9	0.8	2.7	0.4	0.6	0.9	0.4	1.3	2.7
C. Net debt service (A-B)	0.1	0.2	0.3	0.5	0.5	0.3	0.2	0.5	1.5
D. Credit outstanding	8.8	8.8	8.8	8.8	8.8	8.8	8.8	8.8	

Source: Fund staff estimates.
1/ For the Fund, January–September 15.
2/ Figures for the Fund are for the period of the arrangement (September 1, 2003–September 15, 2006).
3/ Uses actual $/SDR rate for 2003, and assumes an exchange rate of US$1.50 per SDR for 2004, US$1.4986 per SDR for 2005, and US$1.5018 per SDR for 2006.
4/ Repurchases are on an obligations basis.

Table 3. Argentina: Quantitative Performance Criteria and Indicative Targets, 2003–04 1/

(In millions of Argentine *pesos* , unless otherwise noted)

	End-Sept. 2003	End-October 2003			End-December 2003			2004			
			Adjusted			Adjusted		Performance Criteria			Indicative
	Actual	Target	Target 2/	Actual	Target	Target 2/	Actual	End-Mar.	End-Jun.	End-Sep.	End-Dec.
Fiscal targets											
1 Cumulative primary balance of the federal government (floor)	7,137	6,940	6,940	8,100	7,790	7,790	8,677	1,100	5,550	8,020	10,240
2 Cumulative overall cash balance of the federal government (indicative target)	1,736	600	600	2,227	350	350	1,886	-670	2,130	3,450	4,370
3 Federal government debt stock (ceiling, in billions of *pesos*) 3/	438	520	498	497	530	514	512	540	550	560	570
4 Stock of federal government arrears (indicative target)	4,625	4,590	4,590	3,965	5,000	5,000	3,786	4,170	5,070	3,970	4,660
5 Cumulative primary balance of the provincial governments (indicative target)	2,646	...	...	...	1,480	1,480	...	180	1,290	2,290	2,540
6 Consolidated public sector debt stock (indicative target, in billions of pesos)	494	542	519	518	552	536	533	563	574	584	594
Monetary targets											
7 Stock of net international reserves of the central bank (in millions of U.S. dollars) (floor) 3/ 4/	...	-4,500	-5,118	-4,695	-4,400	-5,060	-3,404	-4,350	-3,500	-3,300	-2,400
8 Stock of augmented monetary base (indicative target) 5/	...	44,305	44,305	44,379	47,770	47,770	46,892	46,260	49,320	49,625	53,805
9 Stock of augmented net domestic assets of the central bank (ceiling)	...	57,355	59,147	57,994	60,530	62,443	56,763	58,875	59,470	59,195	60,765
10 Consultation mechanism on projected end-2004 inflation (indicative target)											
Upper limit (in percent)	...	...	...	...	11.0	11.0	...	11.0	11.0	11.0	...
Lower limit (in percent)	...	...	...	...	7.0	7.0	...	7.0	7.0	7.0	...

1/ As defined in the Technical Memorandum of Understanding attached to the September 10, 2003, Letter of Intent.
2/ The targets have been adjusted in line with the Technical Memorandum of Understanding.
3/ The following accounting exchange rates apply: Arg$/US$=2.9, US$/SDR=1.3875, Euro/US$=0.869, CAD$/US$=1.347, CHF/US$=1.351, JPY/US$=119.78, GBP/US$=0.604, Gold (U.S.$ per ounce)=371.0.
4/ Excludes Banco de la Nacion deposits and Uruguay bond holdings.
5/ Includes quasi-monies in circulation.

Table 4. Argentina: Selected Economic and Financial Indicators, 1999–2004

	1999	2000	2001	2002	Est. 2003	2004 Orig. Prog.	2004 Proj.
(Annual percent change; unless otherwise indicated)							
National income and prices							
GDP at constant prices	-3.4	-0.8	-4.4	-10.9	8.4	4.0	5.5
Domestic demand (contribution to growth)	-4.8	-1.1	-6.5	-16.9	10.2	4.5	6.8
Net exports (contribution to growth)	1.4	0.3	2.1	6.0	-1.8	-0.5	-1.2
Per capita GDP (in thousands of U.S. dollars)	7.8	7.7	7.2	2.7	3.3	3.8	3.7
Consumer prices (average)	-1.2	-0.9	-1.1	25.9	13.4	9.4	5 - 7
Consumer prices (end-of-period)	-1.8	-0.7	-1.5	41.0	3.7	10.5	7 - 11
Social indicators							
Population below poverty line (in percent) 1/	27.1	29.7	35.4	53.0	54.7	…	…
Population below extreme poverty line (in percent) 1/	7.6	7.5	12.2	24.8	26.3	…	…
Unemployment rate 2/	13.8	14.7	18.3	20.8	14.5	…	…
External sector							
Trade balance (in billions of U.S. dollars)	-2.2	1.1	6.2	16.7	15.5	14.2	14.9
Exports, f.o.b. (in U.S. dollar terms)	-11.8	13.2	0.8	-3.4	14.2	3.3	10.7
Imports, c.i.f. (in U.S. dollar terms)	-18.8	-1.0	-19.5	-55.8	55.3	16.9	27.2
Export volume	-0.7	2.7	4.6	-0.3	5.3	6.9	4.4
Import volume	-13.9	-0.9	-17.3	-54.5	50.8	15.4	22.9
Terms of trade (deterioration -)	-1.7	9.6	-0.6	-1.8	6.9	-4.6	2.5
Money and credit							
Net domestic assets of the financial system	8.6	-0.9	14.9	57.6	1.5	3.9	5.1
Credit to the private sector	-2.3	-3.8	-17.6	-14.5	-15.5	3.4	10.0
Base money	0.8	-8.8	-3.0	152.9	26.3	12.6	15.2
Broad money	3.2	3.2	-16.5	24.7	16.8	17.6	18.4
Interest rate (30-day deposit rate, in percent) 3/	10.2	11.3	15.7	39.1	3.9	...	2.4
(In percent of GDP)							
Consolidated public sector							
Primary balance	-0.8	0.4	-1.3	0.9	3.0	3.0	3.0
Of which : Federal government	0.4	1.0	0.2	0.9	2.3	2.4	2.4
Overall balance	-4.2	-3.6	-5.9	-1.5	1.1	0.9	1.6
Revenues	24.3	24.6	23.7	22.9	25.9	25.3	26.3
Expenditures 4/	28.5	28.2	29.6	24.4	24.8	24.4	24.8
Total debt (in billions of U.S. dollars, year-end) 5/	134.5	144.5	167.8	152.9	185.9	193.0	199.6
Total debt (year-end) 5/	47.4	50.8	62.4	164.5	146.1	132.0	140.4
Of which: External debt 5/	29.9	29.9	32.9	96.1	86.0	...	63.9
Savings-investment balance 6/							
Gross domestic investment	18.0	16.2	14.2	12.0	14.9	18.8	16.6
Of which : Public sector	2.0	1.5	1.5	0.9	1.5	1.9	2.2
Gross national savings	13.8	13.1	12.6	25.8	24.2	26.2	24.6
Of which : Public sector	-2.2	-2.1	-4.5	-0.7	2.6	2.8	3.7
Current account balance	-4.2	-3.1	-1.6	13.8	9.3	7.4	8.0
(In percent of exports of goods and nonfactor services; unless otherwise indicated)							
Outstanding use of Fund resources							
(In percent of quota at end-of-period)	154.1	183.2	525.3	498.2	493.4	510.2	510.2
Gross international reserves (U.S. dollars, billions)	27.3	26.9	14.9	10.5	14.1	15.7	16.2
In months of imports of goods and services	10.0	9.8	6.5	9.7	9.2	9.2	8.5
Nominal GDP (in billions of Arg $)	283.5	284.2	268.7	312.6	374.1	416.9	426.6
(In billions of U.S. dollars)	283.5	284.2	268.7	101.5	126.7	146.6	142.9

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

1/ Data are end-October.
2/ Unemployment data beginning in 2002 are based on new survey methodology introduced December 2003.
3/ 2004 data are at end-February.
4/ Excludes interest due on nonperforming debt.
5/ Figures are staff estimates based on authorities' data.
6/ Cash basis.

Table 5. Argentina: Summary Balance of Payments, 1999–2004

					Est.	2004	
	1999	2000	2001	2002	2003	Orig.	Proj.
(In billions of U.S. dollars)							
Current account 1/	**-11.9**	**-8.8**	**-4.3**	**9.8**	**7.4**	**7.3**	**6.9**
Trade balance	-2.2	1.1	6.2	16.7	15.5	14.2	14.9
Exports f.o.b.	23.3	26.3	26.5	25.7	29.4	29.7	32.5
Imports c.i.f.	-25.5	-25.3	-20.3	-9.0	-13.8	-15.4	-17.6
Services and transfers	-9.7	-9.8	-10.5	-6.9	-8.1	-6.9	-8.1
Of which: Net interest payments 1/	-5.9	-5.9	-7.4	-7.1	-7.3	-5.0	-6.6
Capital and financial account	**14.0**	**7.8**	**-16.6**	**-25.9**	**-17.9**	**-18.6**	**-19.5**
Net public sector capital	10.6	8.1	-2.1	-5.9	-8.5	-9.0	-9.4
Direct investment	7.1	7.3	2.0	1.4	-0.1	0.5	0.5
Other net private sector capital 2/	-3.8	-7.6	-16.5	-21.4	-9.2	-10.1	-10.5
Overall balance	**2.1**	**-1.0**	**-20.9**	**-16.2**	**-10.4**	**-11.3**	**-12.6**
Financing	**-2.1**	**1.0**	**20.9**	**16.2**	**10.4**	**11.3**	**12.6**
Net international reserves (increase -) 3/	-2.1	1.0	20.9	4.8	-2.4	-1.9	-1.6
Change in gross reserves	-1.1	0.4	12.0	4.4	-3.6	-2.1	-2.1
Change in reserve liabilities (IMF)	1.0	-0.6	-8.9	-0.4	-1.2	-0.2	-0.5
Purchases	0.0	2.1	10.6	0.0	5.6	5.3	6.1
Repurchases	0.8	1.3	1.2	0.7	5.7	5.2	5.6
Valuation changes	0.1	0.2	0.5	-1.1	-1.3	0.0	0.0
Exceptional financing	0.0	0.0	0.0	11.4	12.8	13.2	14.2
(In percent of GDP, unless otherwise specified)							
Current account	**-4.2**	**-3.1**	**-1.6**	**9.6**	**5.9**	**5.0**	**4.8**
Trade account	-0.8	0.4	2.3	16.5	12.3	9.7	10.4
Exports, f.o.b.	8.2	9.3	9.9	25.3	23.2	20.2	22.7
Imports c.i.f.	-9.0	-8.9	-7.6	-8.9	-10.9	-10.5	-12.3
External debt service ratio 4/	**100.3**	**105.2**	**108.4**	**98.4**	**...**	**...**	**...**
Of which : Public sector debt	49.4	54.8	65.0	46.8	...	...	...
Memorandum items:							
Current account excluding interest payments on nonperforming debt, in percent of GDP	-4.2	-3.1	-1.6	13.8	9.3	7.4	8.0
Exports volumes, percent change	-0.7	2.7	4.6	-0.3	5.3	6.9	4.4
Imports volumes, percent change	-13.9	-0.9	-17.3	-54.5	50.8	15.4	22.9
LIBOR (6 months U.S. dollar deposits)	5.5	6.6	3.7	1.9	1.2	2.0	1.6

Sources: Ministry of Economy; and Fund staff estimates.

1/ Includes interest due on nonperforming debt but excludes interest on interest arrears.

2/ Includes errors and omissions.

3/ Change in NIR stock during the year. Gross reserves before 2002 include foreign currency securities reported by BCRA to banks. Fund repurchases are on an obligations basis.
Projected SDR figures for 2004 are converted to U.S. dollars at a rate of 1.50 per SDR.

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

Table 6. Argentina: External Financing Requirements and Sources, 2001–04

(In billions of U.S. dollars)

	2001	2002	Est. 2003	2004 Orig.	2004 Proj.
Gross financing requirements	**57.9**	**31.2**	**32.7**	**29.8**	**30.5**
Current account deficit 1/	4.3	-9.8	-7.4	-7.3	-6.9
Capital outflows	53.6	41.0	40.1	37.1	37.3
Public sector amortization	21.2	7.7	18.8	15.3	16.6
IMF	1.2	0.7	5.7	5.2	5.6
Multilateral loans	0.9	2.6	5.3	1.2	1.2
Official bilateral creditors	0.5	0.5	0.7	1.1	1.1
Bonds and notes	7.2	3.1	6.3	7.8	8.6
Other	11.5	0.8	0.7	0.1	0.1
Private sector amortization	17.0	20.0	14.2	14.4	12.7
Other private sector flows, net (+outflows) 2/	15.3	13.3	7.2	7.4	8.1
Available financing	**57.9**	**31.2**	**32.7**	**29.8**	**30.5**
Capital inflows	45.9	15.4	23.5	18.6	18.4
Foreign direct investment	2.0	1.4	-0.1	0.5	0.5
Disbursements to public sector	28.6	0.8	10.2	6.5	7.7
IMF	10.6	0.0	5.6	5.3	6.1
World Bank and IDB	1.8	0.8	4.6	1.2	1.6
Other	16.2	0.0	0.0	0.0	0.0
Private sector borrowing	15.3	13.2	13.4	11.6	10.2
Exceptional financing, arrears	0.0	11.4	12.8	13.2	14.2
Gross reserves accumulation (- increase)	12.0	4.4	-3.6	-2.1	-2.1

Sources: BCRA; and Fund staff estimates.

1/ Includes interest on nonperforming debt.
2/ Includes errors and omissions.

Table 7. Argentina: Consolidated Public Sector Operations, 1999-2004 1/

	1999	2000	2001	2002	2003 Orig. Prog.	2003 Prel. 2/	2004 Orig. Prog.	2004 Proj.
				(In billions of Argentine *pesos*)				
Revenues	**69.0**	**70.0**	**63.6**	**71.5**	**92.9**	**96.9**	**105.4**	**112.4**
Tax revenues	49.7	51.5	47.2	52.4	71.9	74.9	81.7	87.3
Of which : Tax measures	...	...	...	...	...	...	...	-1.8
Social security contributions	10.9	10.7	9.6	9.7	11.5	11.7	13.0	13.5
Other revenues	8.4	7.7	6.8	9.4	9.6	10.2	10.7	11.6
Primary expenditures	**71.1**	**68.7**	**67.2**	**68.8**	**83.6**	**85.6**	**92.8**	**99.4**
Wages	26.6	26.6	26.4	26.2	29.3	29.5	32.2	32.9
Goods and services	6.8	6.0	6.3	6.3	8.3	9.1	8.7	10.5
Transfers to the private sector	27.2	26.8	25.7	28.6	33.9	34.5	35.7	37.2
Of which: Federal pensions	17.4	17.4	16.6	16.5	18.8	19.5	20.6	21.4
Capital spending	5.6	4.3	3.9	2.8	5.3	5.6	7.9	9.3
Other	4.9	5.0	4.9	5.0	6.8	6.9	8.3	9.5
Primary balance	**-2.1**	**1.3**	**-3.6**	**2.7**	**9.3**	**11.3**	**12.5**	**13.0**
Interest cash	9.7	11.5	12.4	7.5	8.9	7.3	8.8	6.4
Overall balance	**-11.8**	**-10.3**	**-16.0**	**-4.8**	**0.4**	**4.1**	**3.7**	**6.6**
Arrears and interest capitalization 3/	0.0	0.0	1.8	49.4	21.3	21.9	21.2	31.8
Debt recognition 4/	1.9	1.6	1.6	0.5	6.1	2.8	4.5	4.5
Bank and depositor compensation 5/	0.0	0.0	0.0	48.2	17.2	1.7	0.0	1.6
Augmented overall balance	**-13.6**	**-11.8**	**-19.3**	**-103.0**	**-44.1**	**-22.3**	**-22.0**	**-31.2**
				(In percent of GDP)				
Revenues	**24.3**	**24.6**	**23.7**	**22.9**	**25.3**	**25.9**	**25.3**	**26.3**
Tax revenues	17.5	18.1	17.6	16.8	19.6	20.0	19.6	20.5
Of which : Tax measures	...	...	...	...	...	... ...	...	-0.4
Social security contributions	3.8	3.8	3.6	3.1	3.1	3.1	3.1	3.2
Other revenues	3.0	2.7	2.5	3.0	2.6	2.7	2.6	2.7
Primary expenditures	**25.1**	**24.2**	**25.0**	**22.0**	**22.7**	**22.9**	**22.3**	**23.3**
Wages	9.4	9.4	9.8	8.4	8.0	7.9	7.7	7.7
Goods and services	2.4	2.1	2.3	2.0	2.2	2.4	2.1	2.5
Transfers to the private sector	9.6	9.4	9.6	9.2	9.2	9.2	8.6	8.7
Of which: Federal pensions	6.1	6.1	6.2	5.3	5.1	5.2	4.9	5.0
Capital spending	2.0	1.5	1.5	0.9	1.5	1.5	1.9	2.2
Other	1.7	1.8	1.8	1.6	1.8	1.9	2.0	2.2
Primary balance	**-0.8**	**0.4**	**-1.3**	**0.9**	**2.5**	**3.0**	**3.0**	**3.0**
Interest cash	3.4	4.1	4.6	2.4	2.4	1.9	2.1	1.5
Overall balance	**-4.2**	**-3.6**	**-5.9**	**-1.5**	**0.1**	**1.1**	**0.9**	**1.6**
Arrears and interest capitalization 3/	0.0	0.0	0.7	15.8	5.8	5.9	5.1	7.4
Debt recognition 4/	0.7	0.6	0.6	0.1	1.6	0.8	1.1	1.0
Bank and depositor compensation 5/	0.0	0.0	0.0	15.4	4.7	0.4	0.0	0.4
Augmented overall balance	**-4.8**	**-4.2**	**-7.2**	**-32.9**	**-12.0**	**-6.0**	**-5.3**	**-7.3**

Sources: Ministry of Economy; and Fund staff estimates.

1/ Revenues and primary spending before 2003 include payments with bonds.
2/ Data for interest capitalization, arrears, debt recognition and bank compensation are estimates.
3/ Includes interest (arrears) on nonperforming debt.
4/ Reflects the settlement of obligations in bonds, often as a result of judicial rulings.
5/ Includes compensation to banks for asymmetric pesoization and asymmetric indexation of balance sheets.

Table 8. Argentina: Federal Government Operations, 1999–2004 1/

	1999	2000	2001	2002	2003 Orig. Prog.	2003 Prel. 2/	2004 Orig. Prog.	2004 Proj.
	(In billions of Argentine *pesos*)							
Revenues	**55.0**	**55.5**	**50.6**	**56.8**	**74.6**	**77.2**	**84.8**	**90.6**
Tax revenues	38.6	40.7	37.4	41.8	58.4	60.7	66.4	71.5
Of which : Tax measures	...	...	...	...	...	...	...	-1.8
Social security contributions	10.9	10.7	9.6	9.7	11.5	11.7	13.0	13.5
Nontax revenues	5.5	4.1	3.6	5.3	4.8	4.7	5.4	5.6
Primary expenditures	**54.0**	**52.7**	**50.0**	**53.8**	**66.8**	**68.5**	**74.7**	**80.2**
Primary expenditures (excluding provinces)	36.1	34.7	33.1	36.3	45.0	45.8	50.0	51.2
Wages	8.5	8.1	7.7	8.0	10.1	10.3	11.1	10.9
Goods and services	2.6	2.3	2.2	2.5	3.0	3.2	3.4	3.9
Pensions	17.4	17.4	16.6	16.5	18.8	19.5	20.6	21.4
Transfers to private sector	6.4	6.2	5.8	8.7	11.2	11.1	11.0	11.3
Capital	1.0	0.7	0.6	0.5	1.4	1.1	2.6	2.7
Other	0.1	0.1	0.1	0.1	0.5	0.5	1.3	1.0
Transfers to provinces	17.8	18.0	17.0	17.5	21.7	22.7	24.7	29.0
Primary cash balance	**1.1**	**2.7**	**0.6**	**3.0**	**7.9**	**8.7**	**10.1**	**10.4**
Interest cash	8.2	9.7	10.2	6.8	7.4	6.9	6.9	5.9
Overall cash balance	**-7.2**	**-6.9**	**-9.6**	**-3.8**	**0.4**	**1.8**	**3.2**	**4.6**
Interest capitalization	0.0	0.0	0.4	32.6	7.5	8.8	10.3	18.8
Accumulation of arrears 3/	0.0	0.0	1.4	16.0	12.7	12.0	10.2	12.2
Debt recognition 4/	1.9	1.6	1.6	0.5	5.7	2.8	2.9	2.9
Bank and depositor compensation 5/	0.0	0.0	0.0	48.2	17.2	1.7	0.0	1.6
Augmented overall balance	**-9.0**	**-8.5**	**-13.0**	**-101.1**	**-42.7**	**-23.5**	**-20.2**	**-30.9**
	(In percent of GDP)							
Revenues	**19.4**	**19.5**	**18.8**	**18.2**	**20.3**	**20.6**	**20.3**	**21.2**
Tax revenues	13.6	14.3	13.9	13.4	15.9	16.2	15.9	16.8
Of which : Tax measures	...	...	...	...	...	...	...	-0.4
Social security contributions	3.8	3.8	3.6	3.1	3.1	3.1	3.1	3.2
Nontax revenues	1.9	1.4	1.3	1.7	1.3	1.3	1.3	1.3
Primary expenditures	**19.0**	**18.6**	**18.6**	**17.2**	**18.2**	**18.3**	**17.9**	**18.8**
Primary expenditures (excluding provinces)	12.7	12.2	12.3	11.6	12.2	12.2	12.0	12.0
Wages	3.0	2.8	2.9	2.6	2.8	2.8	2.7	2.5
Goods and services	0.9	0.8	0.8	0.8	0.8	0.9	0.8	0.9
Pensions	6.1	6.1	6.2	5.3	5.1	5.2	4.9	5.0
Private sector transfers	2.3	2.2	2.2	2.8	3.0	3.0	2.6	2.7
Capital	0.3	0.2	0.2	0.1	0.4	0.3	0.6	0.6
Other	0.0	0.0	0.0	0.0	0.1	0.1	0.3	0.2
Transfers to provinces	6.3	6.3	6.3	5.6	5.9	6.1	5.9	6.8
Primary cash balance	**0.4**	**1.0**	**0.2**	**0.9**	**2.1**	**2.3**	**2.4**	**2.4**
Interest cash	2.9	3.4	3.8	2.2	2.0	1.8	1.6	1.4
Overall cash balance	**-2.5**	**-2.4**	**-3.6**	**-1.2**	**0.1**	**0.5**	**0.8**	**1.1**
Interest capitalization	0.0	0.0	0.1	10.4	2.0	2.3	2.5	4.4
Accumulation of arrears 3/	0.0	0.0	0.5	5.1	3.5	3.2	2.5	2.9
Debt recognition 4/	0.7	0.6	0.6	0.1	1.5	0.8	0.7	0.7
Bank and depositor compensation 5/	0.0	0.0	0.0	15.4	4.7	0.4	0.0	0.4
Augmented overall balance	**-3.2**	**-3.0**	**-4.8**	**-32.4**	**-11.6**	**-6.3**	**-4.8**	**-7.2**

Sources: Ministry of Economy; and Fund staff estimates.

1/ Revenues and primary spending before 2003 include payments with bonds.

2/ Data for interest capitalization, arrears, debt recognition and bank compensation are estimates.

3/ Includes interest (arrears) on nonperforming debt.

4/ Reflects the settlement of obligations in bonds, often as a result of judicial rulings.

5/ Includes compensation to banks for asymmetric pesoization and asymmetric indexation of balance sheets.

Table 9. Argentina: Provincial Government Operations, 1999–2004

	1999	2000	2001	2002	2003 Orig. Prog.	2003 Prel.	2004 Orig. Prog.	2004 Proj.
	(In Arg$ billion)							
Revenue	**31.8**	**32.5**	**29.9**	**32.5**	**40.1**	**42.4**	**45.3**	**50.7**
Tax	11.0	10.9	9.8	10.6	13.5	14.2	15.3	15.8
Nontax	2.9	3.6	3.2	4.4	4.8	5.5	5.2	6.0
Transfers from federal government	17.8	18.0	17.0	17.5	21.7	22.7	24.7	29.0
Primary spending 1/	**35.0**	**34.0**	**34.1**	**32.6**	**38.6**	**39.8**	**42.8**	**48.2**
Wages	18.0	18.6	18.8	18.1	19.2	19.1	21.1	22.0
Goods and services	4.2	3.7	4.1	3.8	5.2	5.9	5.3	6.6
Private sector transfers	3.4	3.2	3.2	3.3	3.8	3.9	4.1	4.5
Public sector transfers 2/	4.8	4.9	4.8	4.9	6.3	6.4	6.9	8.5
Capital	4.7	3.6	3.3	2.4	3.9	4.5	5.3	6.6
Primary balance 1/	**-3.2**	**-1.5**	**-4.2**	**-0.2**	**1.5**	**2.6**	**2.5**	**2.5**
Net arrears reduction (-, accumulation)	...	...	...	1.0	1.0	0.9	0.2	0.2
Primary balance (cash basis)	-3.2	-1.5	-4.2	-1.1	0.5	1.8	2.2	2.3
Interest (cash basis)	1.4	1.9	2.4	1.5	2.0	1.7	2.1	2.1
Overall cash balance	**-4.6**	**-3.3**	**-6.6**	**-2.6**	**-1.5**	**0.0**	**0.2**	**0.2**
Debt recognition expenditures 3/	...	...	...	...	0.4	0.0	1.6	1.6
Interest capitalization 4/	0.0	0.0	...	8.3	1.8	1.8	2.4	2.4
Interest arrears	0.0	0.0	0.0	0.8	1.0	1.1	0.7	0.7
Augmented balance	**-4.6**	**-3.3**	**-6.6**	**-11.8**	**-4.7**	**-2.8**	**-4.5**	**-4.5**
	(In percent of GDP)							
Revenue	**11.2**	**11.4**	**11.1**	**10.4**	**10.9**	**11.3**	**10.9**	**11.9**
Tax	3.9	3.8	3.6	3.4	3.7	3.8	3.7	3.7
Nontax	1.0	1.3	1.2	1.4	1.3	1.5	1.3	1.4
Transfers from federal government	6.3	6.3	6.3	5.6	5.9	6.1	5.9	6.8
Primary spending 1/	**12.4**	**12.0**	**12.7**	**10.4**	**10.5**	**10.6**	**10.3**	**11.3**
Wages	6.4	6.5	7.0	5.8	5.2	5.1	5.1	5.2
Goods and services	1.5	1.3	1.5	1.2	1.4	1.6	1.3	1.5
Private sector transfers	1.2	1.1	1.2	1.1	1.0	1.0	1.0	1.1
Public sector transfers 2/	1.7	1.7	1.8	1.6	1.7	1.7	1.7	2.0
Capital	1.6	1.3	1.2	0.8	1.1	1.2	1.3	1.5
Primary balance 1/	**-1.1**	**-0.5**	**-1.6**	**-0.1**	**0.4**	**0.7**	**0.6**	**0.6**
Net arrears reduction (-, accumulation)	...	...	...	0.3	0.3	0.2	0.1	0.1
Primary balance (cash basis)	-1.1	-0.5	-1.6	-0.4	0.1	0.5	0.5	0.5
Interest (cash basis)	0.5	0.7	0.9	0.5	0.6	0.5	0.5	0.5
Overall cash balance	**-1.6**	**-1.2**	**-2.5**	**-0.8**	**-0.4**	**0.0**	**0.0**	**0.1**
Debt recognition expenditures 3/	...	...	...	...	0.1	0.0	0.4	0.4
Interest capitalization 4/	0.0	0.0	...	2.7	0.5	0.5	0.6	0.6
Interest arrears	0.0	0.0	0.0	0.3	0.3	0.3	0.2	0.2
Augmented balance	**-1.6**	**-1.2**	**-2.5**	**-3.8**	**-1.3**	**-0.8**	**-1.1**	**-1.0**
Memorandum item:								
Provincial financing (net)	1.6	1.3	2.6	0.7	0.4	-0.4	0.0	-0.1
Amortization	...	-0.9	-0.8	-0.6	-2.1	-2.0	-0.6	-0.6
Gross financing	...	2.2	3.4	1.3	2.5	1.6	0.6	0.6

Sources: Ministry of Economy; and Fund staff estimates.

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

Table 10. Argentina: Summary Operations of the Financial System, 1999-2004

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

	1999	2000	2001	2002	2003	2004 Orig. Prog.	2004 Proj.
I. Central Bank							
Net international reserves	13.2	12.1	-7.1	-20.7	-11.9	-5.5	-8.2
Net domestic assets	3.3	3.0	19.0	49.9	58.3	59.3	62.0
Credit to the public sector (net)	5.4	5.7	15.7	54.1	61.2	56.7	61.9
Credit to the financial sector (net)	1.4	1.0	5.0	23.4	17.8	15.1	17.8
Central bank bonds (*Lebacs*)	...	...	...	-3.2	-9.6	-5.2	-7.5
Official capital and other items (net)	-3.5	-3.7	-1.7	-24.5	-11.1	-7.3	-10.2
Monetary base	16.5	15.1	11.9	29.2	46.4	53.8	53.8
Currency issued	16.5	15.1	11.0	18.8	30.3	34.4	34.1
Bank deposits at the central bank	...	...	0.9	10.3	16.1	19.4	19.7
II. Banks and Nonbank Financial Institutions							
Net foreign assets	-2.1	2.4	-6.2	-27.4	-15.5	0.4	-6.4
Net domestic assets	72.0	71.3	66.4	92.9	92.8	101.1	99.5
Credit to the public sector (net)	18.8	19.7	24.1	85.1	76.9	81.9	77.3
Credit to the private sector	70.6	67.9	56.0	47.8	40.4	41.5	44.5
Claims on the central bank (net)	3.8	3.5	4.7	-12.6	-0.9	-3.3	0.7
Capital and reserves	-16.9	-17.3	-16.5	-26.0	-21.8	-19.4	-21.8
Other	-4.3	-2.5	-1.9	-1.5	-1.8	0.5	-1.2
Private sector deposits	69.9	73.7	60.2	65.5	77.3	101.5	93.1
Local currency	26.7	26.0	15.9	63.3	74.6	97.0	89.9
Foreign currency	43.2	47.7	44.2	2.2	2.7	4.5	3.2
III. Consolidated Financial System							
Net foreign assets	11.1	14.4	-13.3	-48.1	-27.4	-5.2	-14.5
Net domestic assets	72.5	71.8	82.5	130.1	132.0	138.3	138.7
Credit to the public sector (net)	24.3	25.4	39.8	139.3	138.1	138.6	139.3
Credit to the private sector	70.6	67.9	56.0	47.8	40.4	41.5	44.5
Net capital, reserves, and other assets	-22.3	-21.5	-13.2	-57.0	-46.5	-41.7	-45.0
Liabilities to the private sector (broad money)	83.6	86.3	69.3	81.9	104.5	133.2	124.2
Currency in circulation	13.7	12.6	9.1	16.4	27.3	31.7	31.1
Local currency deposits	26.7	26.0	15.9	63.3	74.6	97.0	89.9
Foreign currency deposits	43.2	47.7	44.2	2.2	2.7	4.5	3.2
Memorandum items:							
Augmented base money 2/	16.5	15.1	14.6	37.0	46.7	53.8	53.8
M1 3/	20.1	18.7	20.8	35.7	42.0	48.2	48.7
M3 4/	83.6	86.3	72.0	89.8	104.9	133.2	124.2
(Annual percent change)							
Augmented base money	0.8	-8.8	-3.0	152.9	26.3	12.6	15.2
M1	-1.8	-6.8	10.7	71.9	17.7	14.1	16.1
M3	3.2	3.2	-16.5	24.7	16.8	17.6	18.4
Credit to the private sector	-2.3	-3.8	-17.6	-14.5	-15.5	3.4	10.0

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

1/ Projections based on data up to October 2003 for banks and nonbanks, data to January for the BCRA. Foreign currency items in projections are valued at the an exchange rate of Arg$2.91 per U.S. dollar, and US$1.5 per SDR.

2/ Base money plus quasi-monies in circulation.

3/ Currency in circulation plus demand deposits plus quasi-monies in circulation.

4/ M1 as defined in footnote 3, plus foreign- and domestic-currency time and savings deposits.

Table 11. Consolidated Public Debt: 2001-04

(In US$ billions, except where noted; end period)

	2001	2002	Est. 2003	Proj. 1/ 2004
Total debt (I+II)	**167.8**	**152.9**	**185.6**	**199.6**
In percent of GDP	*62.4*	*164.5*	*145.8*	*140.4*
I. Federal government	**144.5**	**137.3**	**178.5**	**192.2**
A. Official debt	36.8	36.0	38.3	39.6
1. Multilaterals	32.4	31.1	31.8	32.9
IMF	14.0	14.3	15.5	16.2
World Bank	9.7	8.5	7.5	7.9
IADB	8.7	8.4	8.8	8.8
2. Bilateral	4.5	4.9	6.5	6.6
B. Private creditors	42.3	98.4	134.2	145.9
1. Performing debt	42.3	37.0	39.0	43.9
a. Banks (Bodens), compensation for:	0.0	8.9	8.3	9.1
Asymmetric pesoization	0.0	0.0	5.9	6.2
Foreign exchange exposure (Cobertura bonds)	0.0	2.4	2.4	2.4
Asymmetric indexation	0.0	0.0	0.0	0.5
b. Depositors (Bodens)	0.0	5.3	6.1	7.5
Exchange of deposits for bonds	0.0	...	6.1	6.2
Compensation associated with deposit liberalization	0.0	...	0.0	1.3
c. Civil servants (compensation for 2001 13 percent wage cut)	0.0	0.0	0.9	1.0
d. Phase 1 debt 2/	42.3	22.8	23.8	26.3
2. Nonperforming (Phase 2) debt 3/	...	61.4	95.2	102.0
C. BCRA (Quasi-monies bonds)	0.0	0.0	2.4	2.8
D. Other	65.4	2.9	3.7	4.0
Treasury bills, bonds and other short-term instruments	61.8	0.0	0.0	0.0
Central bank short-term financing	0.0	1.1	2.5	2.9
Banks and other	3.6	1.8	1.1	1.2
II. Provincial governments (net of intergovernmental debt)	**23.3**	**15.6**	**7.1**	**7.4**
Memorandum items:				
Nonperforming debt 4/	...	92.8	106.3	113.5
Performing debt	167.8	60.1	79.3	86.2
Multilaterals 5/	32.4	14.3	31.8	32.9
Private creditors, BCRA, and other	135.4	38.1	43.9	49.5
Of which: Bodens	0.0	14.2	17.6	20.4

Sources: Argentine authorities; and staff projections.

1/ Assumes no restructuring of Phase 2 debt.

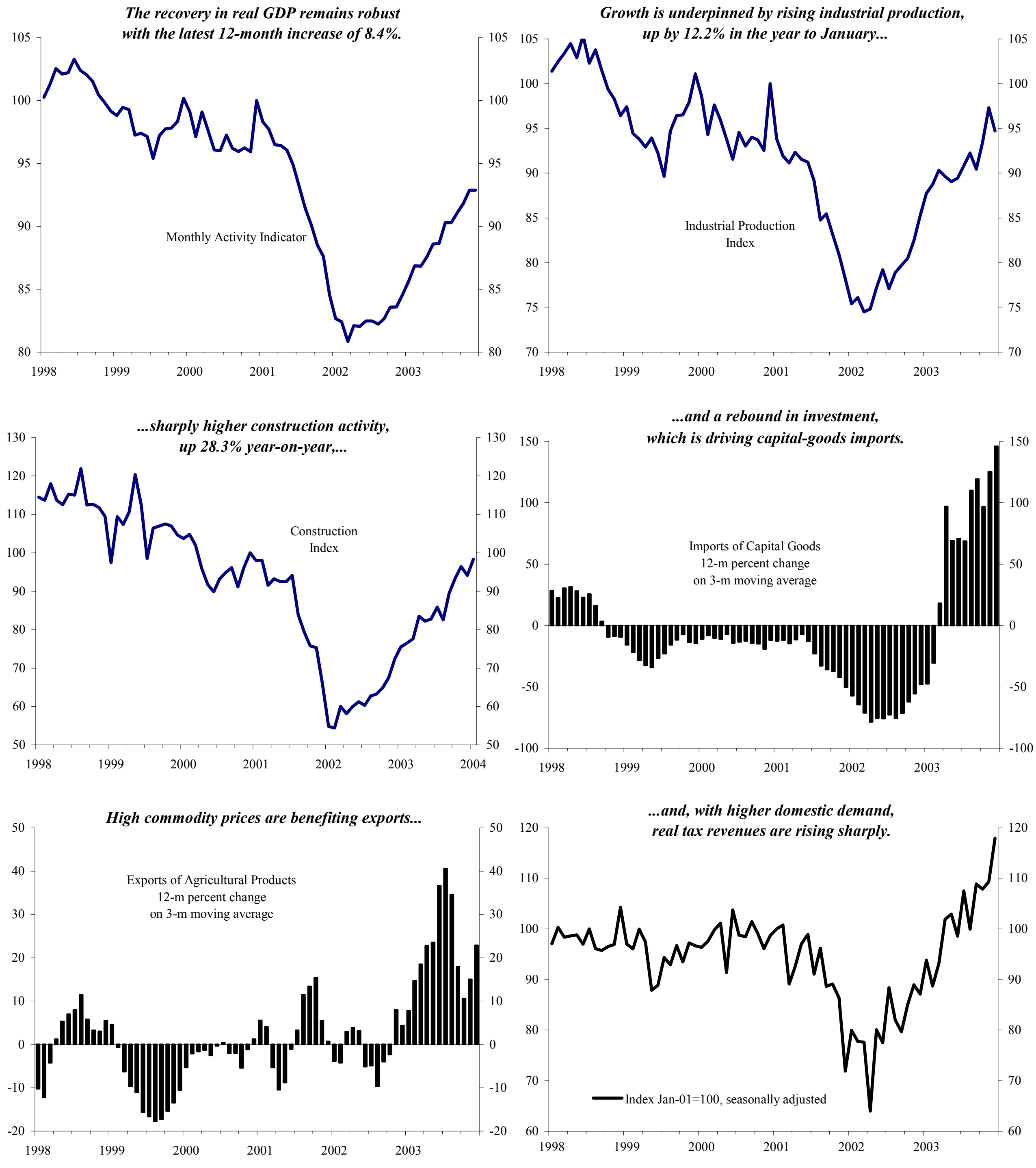
2/ Includes provincial debt assumed by the federal government.

3/ Includes the effect of converting *pesoized P* hase 2 bonds to their original U.S. dollar values.

4/ Includes the sum of non-performing Phase 2 debt, bilateral, bank and other debt, and assumes half of provincial debt is nonperforming.

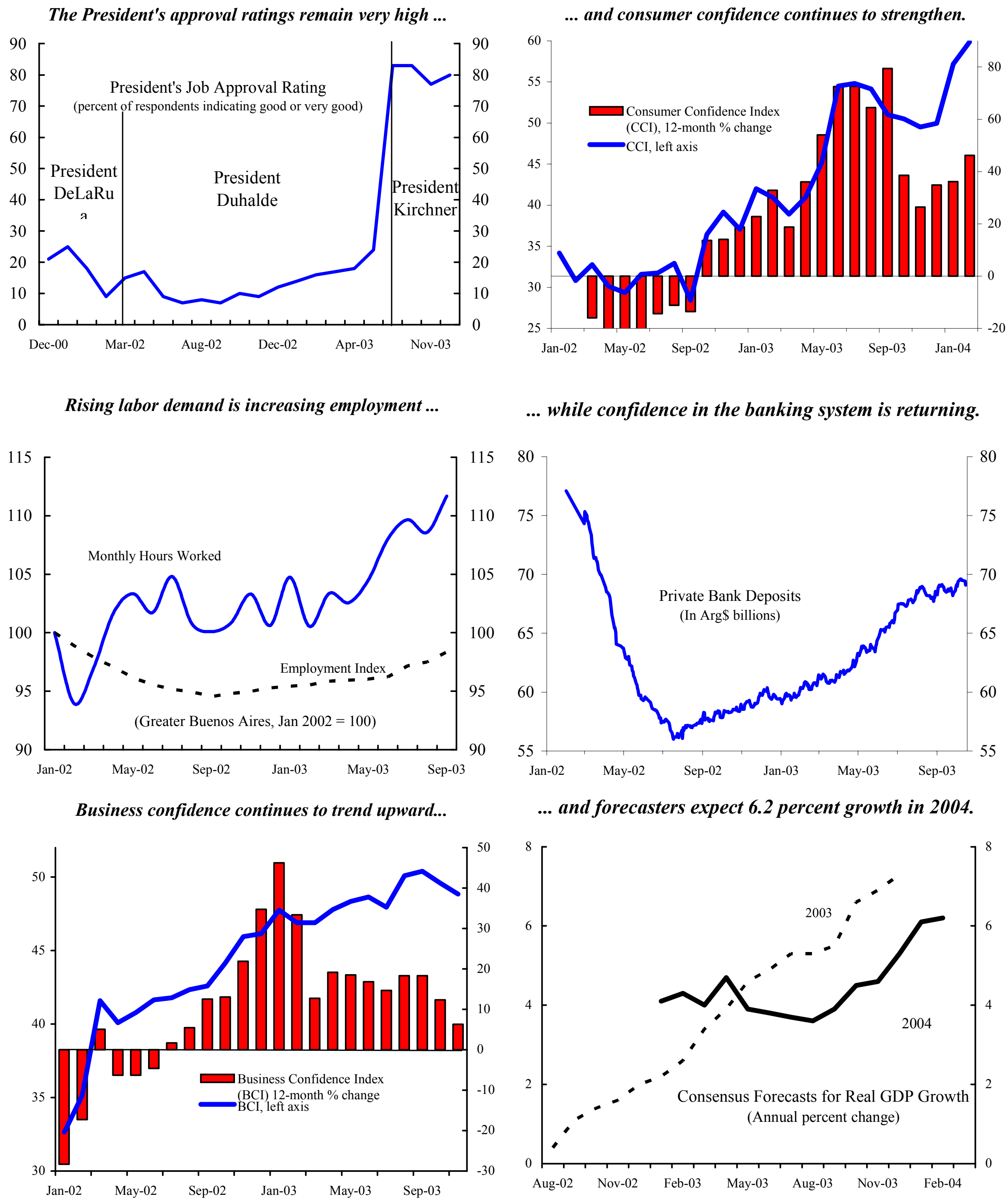
5/ Reflects arrears to multilateral development banks at end 2002.

Figure 1. Argentina: Indicators of Real Activity
Index Dec-2000 = 100, except where noted



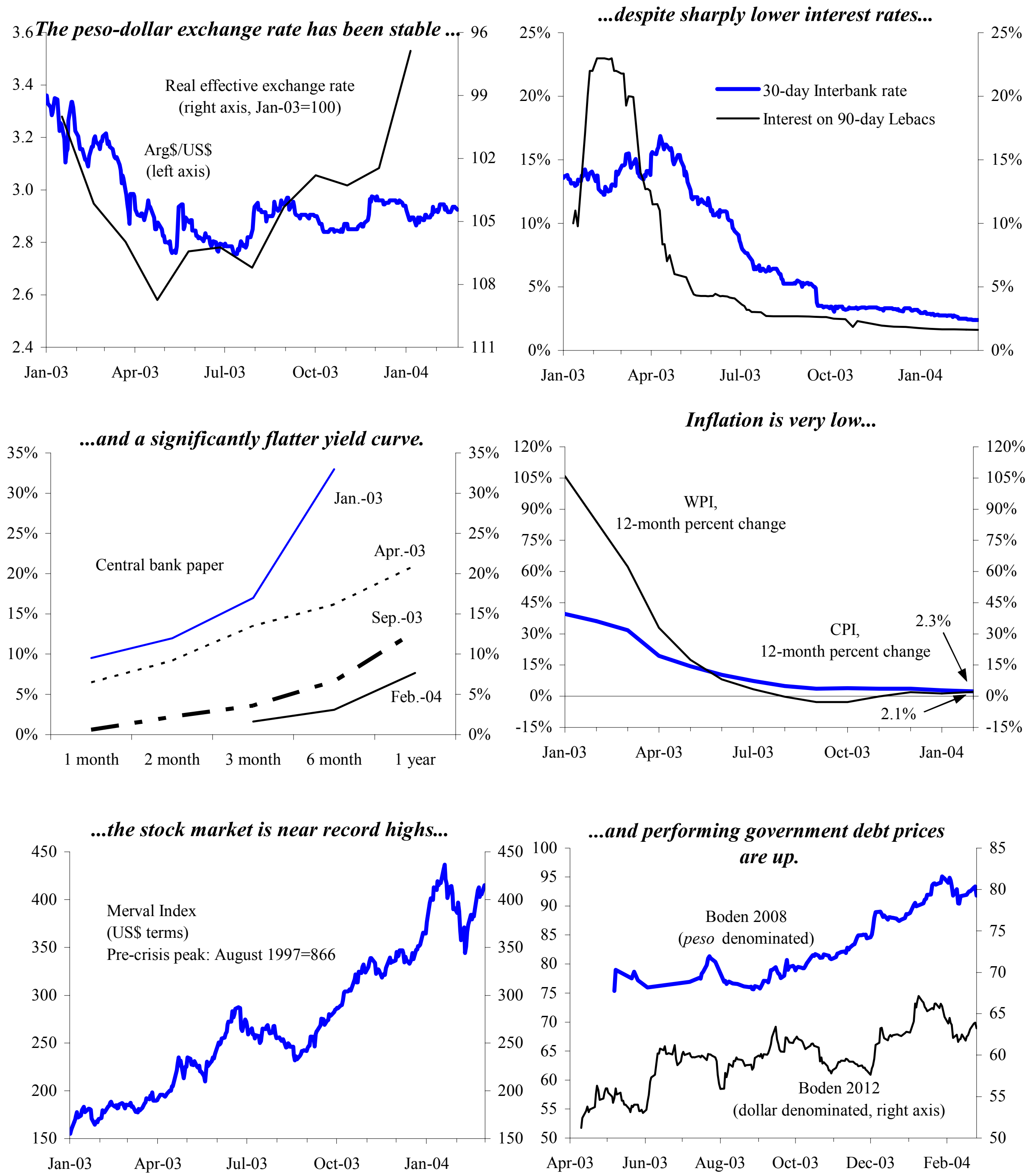
Sources: Ministry of Economy of Argentina; and INDEC.

Figure 2. Argentina: Confidence Indicators



Sources: Ministry of Economy of Argentina; INDEC; IPSOS-MORA y ARAUJO; JP Morgan.

Figure 3. Argentina: Recent Financial Indicators



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

FUND RELATIONS
(As of January 31, 2004)

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	12,804.21	604.80
Reserve position in Fund	0.06	0.00

III. SDR Department:	**In Millions of SDRs**	**Percent of Allocation**
Net cumulative allocation	318.37	100.00
Holdings	919.08	288.68

IV. Outstanding Purchases and Loans:	**In Millions of SDRs**	**In Percent of Quota**
Extended Fund arrangements	469.67	22.18
Stand-By Arrangements	10,217.50	482.62

V. Latest Financial Arrangements

			SDR Millions	
Type	**Approval Date**	**Expiration Date**	**Amount Approved**	**Amount Drawn**
Stand-By	09/20/03	09/19/06	8,981.00	2,071.00
Stand-By	01/24/03	08/31/03	2,174.50	2,174.50
Stand-By	03/10/00	01/23/03	16,936.80	9,756.31
Of which: SRF	01/12/01	01/11/02	6,086.66	5,874.95

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

	Forthcoming				
	2004	**2005**	**2006**	**2007**	**2008**
Principal	4,397.76	2,794.69	2,113.97	1,350.61	30.13
Charges/interest	277.21	124.49	61.55	17.87	0.19
Total	4,674.98	2,919.18	2,175.52	1,368.48	30.31

VII. **Safeguards Assessments:** The Central Bank of Argentina (BCRA) is subject to a safeguards assessment under the current Stand-By Arrangement. An on-site assessment of the BCRA was performed in December 2003, along with a follow up on the status of recommendations made under the previous assessment of the BCRA, completed on September 05, 2002. The priority recommendations of the on-site assessment are: (i) the publication of audited annual financial statements based on International Financial Reporting Standards (IFRS), commencing with the year ending December 31, 2003; and (ii) extension of strengthened control procedures to ensure that all monetary data reported to the Fund under the program reflect the TMU. The authorities have committed to prepare and provide to the Fund financial statements based on IFRS by June 30, 2004. They have also committed to extend their internal control procedures for data verification and reporting to all monetary data under the program on a quarterly basis, beginning end-March 2003.

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 ₳10,000 per U.S. dollar. On January l, l992 the *peso* was substituted for the austral at a rate of l peso per 10,000 australes. On January 7, 2002, the currency board arrangement was abandoned in favor of a dual exchange rate regime with an official rate of Arg$1.4 per U.S. dollar for most trade, trade finance, and public sector transactions; remaining transactions were at a market floating rate. On February 11, 2002, the dual exchange rate regime was abolished and substituted by a floating regime with no pre-announced rate of the exchange rate.

All Article VIII restrictions have been removed other than: (i) the restriction arising from the freezing of deposits pursuant to the *corralón* (which has been approved by the Board until the earlier of March 2004 or the conclusion of the next Article IV consultation with Argentina); and (ii) a restriction arising from limitations on the ability of financial institutions to make moderate loan amortization payments.

IX. **Last Article IV consultation**: The 2002 Article IV consultation was concluded by the Executive Board on January 8, 2003.

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
MFD	Bank Restructuring	March 2002
LEG	Insolvency Law and Other Legal Issues	April 2002
MFD	Bank Restructuring	April 2002
MFD	Bank Restructuring	May 2002
MFD	Bank Restructuring	June 2002
MFD	Bank Restructuring	July 2002
MFD	Bank Restructuring	August 2002
MFD	Bank Restructuring	September 2002
FAD	Public Expenditure Management	September 2002
LEG	Insolvency Law and Other Legal Issues	November 2002
FAD	Customs Administration	November 2002
MFD	Development of Banking Model	November 2002
FAD	Tax Policy	February 2003
MFD	Bank Restructuring	March 2003
FAD	Intergovernmental Relations	April 2003
MFD	Bank Restructuring	May 2003
MFD	Bank Restructuring	July 2003
MFD	Bank Restructuring	August 2003
MFD	Banking Strategy	October 2003
MFD	Banking Strategy	February 2004

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

RELATIONS WITH THE WORLD BANK GROUP[1]

1. The total current Bank portfolio in Argentina is composed of 32 loans totaling US$4.6 billion in commitments. Twenty-eight loans correspond to investment projects totaling US$3.1 billion in commitments, of which US$1.0 billion remain undisbursed. The remaining four are adjustment operations totaling US$1.5 billion in commitments, of which US$526 million remain undisbursed. The latter category includes the Provincial Maternal-Child Health Sector Adjustment Loan, for US$750 million, signed on October 31, 2003. Upon effectiveness of the loan declared on November 6, 2003, US$450 million of the first tranche were disbursed. The current level of exposure of the Bank in Argentina stands at US$7.5 billion.

2. The last Country Assistance Strategy (CAS) Report was discussed at the Board on June 27, 2000 and was subsequently updated via a CAS Progress Report dated October 1, 2001. Bank's strategy has been somewhat overcome by the crisis that erupted in end-2001. The Bank has since then adjusted its proposed strategy to respond to the needs emerging from the acute increase in poverty and to support the transition towards the normalization of the economic and social conditions.

3. The Bank's response to the crisis situation included three major steps: (i) US$270 million were re-allocated from existing projects to emergency social programs in the areas of nutrition, health, and education; (ii) in January 2003 the Board approved the Heads of Household loan for US$600 million, the main program to assist the unemployed, benefiting about two million households; and (iii) in May 2003, the Board approved a US$500 million Economic and Social Transition Loan that supported the redemption of the quasi-monies issued by the provinces and ensured continued execution of programs dealing with the provision of essential social services.

4. On October 28, 2003 the Bank approved a $750 million loan to support the Government's Health Sector Reform Program that aims to increase the availability and effectiveness of public subsidies in improving the health status of the poor. This loan will specifically support the implementation of a Maternal and Child Health Insurance Program, initiate a major effort to reach the lowest income provinces in Argentina and shift public subsidies from the non-poor to the poor who are largely uninsured. The Loan will be disbursed in three tranches over a period of approximately one year.

5. Efforts to improve performance of the Bank's investment portfolio have fallen short of expectations. About half of the Bank's investment portfolio continues to be rated as unsatisfactory for implementation progress. There has been a pickup in disbursements during the last quarter of calendar year 2003, which ended with total disbursements reaching

[1] Prepared by the staff of the World Bank on February 23, 2004.

US$618 million, of which US$352 million correspond to the Heads of Household Program, and US$98 million to reallocations made in support of the social emergency. The adjustment portfolio consists of four loans with an amount of $526 million remaining undisbursed. The last tranches of the Córdoba, Santa Fe and Catamarca PRLs, totaling US$226 million, are expected to be disbursed during the first semester of calendar year 2004. The two remaining tranches of the Provincial Maternal-Child Health Sector Adjustment Loan are expected to be disbursed during the calendar year.

6. A new Country Assistance Strategy is expected to be presented to the Board early in calendar year 2004, together with a structural adjustment loan to support economic recovery.

Financial Relations with the World Bank

(In millions of U.S. dollars)

	Commitments (Net of Cancellations)	Disburse-ments	Undisbursed Amount
I. IBRD Operations (as of February 23, 2004)			
Fully disbursed loans	14,429.6	14,429.6	0.0
Loans in process of disbursement	4,588.5	3,017.3	1,571.3
A. Investment operations			
Agriculture and rural development	246.5	108.5	138.0
Power	30.0	2.8	27.2
Municipal/provincial development	430.9	392.1	38.9
Water sector	30.0	6.4	23.6
Social sector	1,155.3	790.7	364.6
Finance, infrastructure, and natural resources	1,192.0	772.9	419.1
Public administration	50.8	16.9	33.9
B. Adjustment operations	1453. 0	927.0	526.00
Total loans	19,018.1	17,446.9	1,571.3

II. IFC Operations (as of January 31, 2004)

	Loans	Equity	Quasi	Partici-pation
Held	530.7	169.1	164.4	747.4
Disbursed	524.7	110.3	164.4	747.4

III. IBRD Loan Transactions

	Actuals (Calendar Year)					
	1998	1999	2000	2001	2002	2003
Disbursements	2,030.6	1,572.9	1,018.8	1,328.8	424.5	1,962.9
Debt service payments	350.2	445.0	538.1	675.5	1,352.8	2,968.1
Net transfers	1,680.4	1,127.9	480.7	653.3	-928.3	-1,005.2

RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK[1]

Portfolio

1. The Bank adjusted its activities in Argentina in 2002 and 2003 to better respond to a new economic, social and political context. In particular it:

- Tightened supervision of its portfolio to take into account harsher fiscal constraints;
- Reformulated its social and productive sector portfolios in order to better respond to the government's priority areas as well as to improve portfolio performance. To this end, in March 2002, board authorization was given to redirect US$694.2 million from low-performing operations of lesser priority to support the Argentine government's Social Emergency Plan for social protection and containment programs, with special emphasis on food, medicines, and education programs. Results to date have been positive both in terms of physical and disbursement targets. In November 2003, the Board approved the reformulation of the Bank's productive sector portfolio in order to help revitalize economic activity and improve the competitiveness of the productive sectors. This has resulted in the redirectioning of US$296 million toward programs that support small and microenterprises and small rural producers.

2. Early in 2003 the second tranches of two sector loans were reformulated in order to better respond to new needs: 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 was split into two, conditionalities were met and the loans were fully disbursed by the end of 2003.

3. As of December 31, 2003 IDB disbursements for the year totaled US$2.658 billion, of which US$1.9 billion were for emergency loans, US$490 million for policy-based loans and US$268 million for investment loans. For the year as a whole, the net loan flow of resources to the country was positive in US$320 million, the net cash flow was negative in US$305 million.

[1] Prepared by IDB staff, February 2004.

Lending program and country strategy

4. Under the umbrella of the Transition Program and the three-year stand-by agreement between Argentina and the IMF, approved in January and September 2003, respectively, the Bank approved two emergency loans for US$1.9 billion to protect social expenditure. These loans have been fully disbursed.

5. Additionally, two direct investment loans to the provinces of Salta and Río Negro were approved in 2003, for a total of US$86 million, with the objective of revitalizing economic growth by supporting productive sectors with greater comparative advantages.

6. The Bank has carried out dialogue missions to discuss its future country strategy and lending program with the authorities for the period 2004–08. Work on this strategy has included a series of internal workshops and the preparation of sector-specific studies. A consultation workshop was carried out with the government, private sector and civil society in February 2004 and several workshops are planned for the first semester of 2004 on Competitiveness, Governance and Social Development. The country strategy is planned for approval in the first semester of 2004.

Buenos Aires, March 10, 2004

Ms. Anne O. Krueger
Acting Managing Director
International Monetary Fund
Washington D.C.

Dear Ms. Krueger:

Developments under the economic program continue to be very favorable, helping us to lay the foundations for sustainable growth and poverty reduction. The end-December 2003 quantitative performance criteria were met comfortably and all continuous structural performance criteria were observed. Furthermore, our plans for structural fiscal reform, the further strengthening of the banking sector, and carrying forward utility sector reform remain firmly on track. We are also entering a critical stage in the restructuring of sovereign debt.

Macroeconomic framework

Argentina's economy is expanding at a faster pace than projected, with real GDP estimated to have increased by 8.4 percent in 2003. Disciplined implementation of well-designed monetary and fiscal policies contributed to strengthening consumer and business confidence, reducing inflation, lowering interest rates, and rekindling private investment. The banking system is returning to profitability and bank deposits are growing strongly. Consumption was boosted by the rise in real incomes as a result of both higher wages and stronger labor demand, which in turn contributed to reducing unemployment and poverty rates. We expect the strong recovery to continue in the period ahead and have revised upward the growth outlook for 2004 to about 5½ percent, mainly on the back of robust domestic demand. Favorable external conditions should allow the continuation of a high trade surplus, despite a continued steep rise in imports of capital goods and intermediate inputs. As foreseen in the September agreement, we expect a modest and transitory increase in inflation, as a result of pending adjustments in relative prices (especially regulated prices), some recovery in retail margins, and the lagged impact of higher commodity prices.

Monetary and fiscal policies

All monetary targets for end-December 2003 were met with large margins and the monetary program remains well on track. The balance of payments remains strong and record sales of central bank bonds (*lebacs*) kept central bank NDA substantially below the program ceiling. Twelve-month inflation fell below 3 percent in January 2004 and all quasi-monies have now been removed from circulation. While we remain committed to the original targets of the monetary program, the combination of modest exchange rate appreciation and continuous reserve accumulation, rapidly growing bank deposits and falling interest rates, and subdued inflation, suggests a continuing strong recovery in the demand for money. If these trends continue, this may warrant some easing of the base money target at the third review of the program.

The end-December fiscal and debt targets of the program were also met by wide margins. In 2003, the primary surplus of the consolidated public sector was about 3 percent of GDP, ½ percentage point above the target. This good performance is the result of both buoyant revenues—reflecting a stronger-than-expected economic recovery and intensified policies and efforts to combat tax evasion—and continued control over spending at the federal and provincial levels. Tax revenues are expected to remain above program levels in 2004, which should enable us to comfortably meet the targeted primary surplus of 3 percent of GDP, while making room for a reduction in the distortionary financial transactions tax by July 2004. The government is also committed to targeted increases in capital and social spending. The 2004 bilateral agreements have been signed by 12 provincial governors and ratified by sufficient provincial legislatures to meet the related structural performance criterion well ahead of the end-March 2004 deadline.

Structural fiscal reforms

Plans for structural fiscal reforms are advancing in line with our commitments in the September 10, 2003 Memorandum of Economic and Financial Policies (MEFP) and accompanying Technical Memorandum of Understanding (TMU). A formal agreement with provincial governors on the main elements of the fiscal responsibility and intergovernmental reform legislation (described in MEFP paragraph 31, and TMU Section III.c) is expected by end-March 2004 (structural performance criterion). These reforms aim to ensure budgetary discipline for provincial governments, simplify the tax revenue-sharing arrangements, improve incentives to raise own revenues, and ensure a more equitable distribution of transfers among provinces. The legislation is to be submitted to Congress by end-May 2004, with ratification by federal and provincial legislatures expected by end-August 2004 (both structural performance criteria).

We have initiated work on the planned tax policy reform (MEFP paragraph 28) aimed at strengthening core taxes and allowing for the phased elimination of distortionary taxes, including the planned reduction in the financial transactions tax. As originally anticipated, the reform will be discussed at the third review of the arrangement, and legislation will be submitted to Congress by end-September 2004 along with a 2005 budget consistent with the program targets for 2005 (structural performance criteria).

We plan to submit to Congress by end-March 2004 legislation to further strengthen tax compliance covering customs duties and social security contributions (MEFP paragraph 29) (structural benchmark). In the area of social security reform, a draft proposal to extend the coverage and increase the efficiency of the system is expected to be made public by June 2004 to elicit comments from all interested stakeholders; reform legislation will then be submitted to Congress during the second half of 2004.

The banking strategy

Additional measures are being taken to strengthen banks' capital and profitability so as to facilitate the credit creation needed to sustain the recovery.

- Progress is being made in finalizing bank compensation payments. In the case of asymmetric *pesoization*, compensation bonds were placed in advance in escrow accounts; the central bank has recently completed the process of claim verification and informed banks where there has been an overestimation of compensation due. With respect to the compensation for losses from asymmetric indexation, implementing regulations have been issued, and the central bank will soon issue additional instructions to the banks to formalize the process. However, given the complexity of the verification process, compensation will spill over to the second quarter. Therefore, the end-March 2004 target will be missed and we request the structural performance criterion to be reset to end-June 2004.

- After being suspended for two years, the capital adequacy regime was reintroduced in January 2004. Accordingly, banks are required to build gradually an adequate capital cushion against exposure to the public sector and interest rate risk. Banks that are found not to be in compliance with the new capital adequacy norms or that are expected to incur significant future losses are required by the central bank to take prompt corrective actions and are subjected to intensified monitoring by supervisors.

- Following the submission and analysis of annual business plans, the central bank has requested all banks to submit multi-year business plans by end-March 2004. Following the review of such plans, the central bank will augment its work and reach agreement with all banks on strategies to ensure the viability of their operations in the context of mutually acceptable multi-year business plans by end-June 2004 (structural benchmark).

As regards the major public banks, and as anticipated at the last review, new bids were launched on February 27, 2004 on agreed terms of references for the selection of the financial advisors to conduct the due diligence and strategic reviews of Banco de la Nación and Banco de la Provincia de Buenos Aires. We expect to select the advisors by end-June 2004 (structural performance criterion) and to complete the strategic review of Banco de la Provincia de Buenos Aires by end-September 2004 and of that for Banco de la Nación by end-November 2004; time-bound action plans for strengthening these banks will be finalized by end-December 2004 (structural performance criterion).

The working group charged with the design of reforms of the central bank is finalizing its report containing its key findings and recommendations and plans to issue it by end-March 2004 (structural benchmark). Based on the report's findings and feedback from a wider audience, the authorities will finalize recommendations by September 2004.

With regard to the safeguards assessment program for central banks, by end-June 2004 the central bank will begin providing financial statements to the Fund in accordance with International Financial Reporting Standards, commencing with the end-December 2003 financial year (structural benchmark). In addition, beginning in March 2004 the central bank's externally appointed controller (the *Síndico*) will verify and report to the Fund that all monetary data used for program monitoring purposes have been prepared in accordance with the Technical Memorandum of Understanding.

Legal framework for private corporate restructuring

We have completed the reports on the corporate insolvency framework and the financial condition of the corporate sector, the latter of which shows that substantial progress has been made in restructuring corporate debt in the context of the existing insolvency framework. We are studying the modalities for distributing these reports to a wider audience for comment.

Utility sector reform

We have taken some key steps to advance reforms in this sector, including: (i) initiating tariff increases for key sectors; (ii) pressing forward in the renegotiation of some key concessions; and (iii) updating information of the financial condition of the utility sector as a guide toward further policy evolution.

Regarding the tariff increases, a key step in restoring the viability of the nonregulated energy concessions was taken in mid-February 2004 with the announcement of an increase in tariffs charged to industry-level users for electricity and natural gas, and for liquid gas used in passenger transport. The increases will be in the range of 10–35 percent and will be implemented retroactively to February 2004 in the case of electricity. For gas, increases will become effective by May 2004 after public hearings. The Energy Secretariat has been granted the power to negotiate the specific adjustments on a bilateral basis with gas producers.

Regarding progress in the renegotiation of the 62 concessions, we have allowed 13 inter-urban road concessions to expire, and awarded new concessions to operate and maintain this infrastructure. We expect to complete the renegotiation of an additional 39 concessions by end-June 2004, and all others by end-2004. The renegotiated contracts will then be subject to public hearings, a review by control entities, and final ratification by Congress.

In February 2004, we invited a joint World Bank-IMF fact-finding mission to update the assessment of the utilities sector and the progress made in the renegotiation of concessions, as part of our previous commitment to work with the international community in this area. The recommendations of the joint mission will provide an input to complete the process of renegotiating the concessions in a timely manner. As a next step, we will invite the Bank and the Fund to discuss this assessment and to detail the areas where the government will seek Bank cooperation.

We are also aiming to strengthen the regulatory framework for the utilities sector. Given that some additional time is needed for further discussion of the issues involved with domestic and international experts, including the World Bank, the legislation to implement the new regulatory framework will be submitted to Congress during the second half of 2004. The framework will be formulated in a manner that is fully consistent with the renegotiated concessions, supportive of private sector participation in the provision of public services, and our social objective of protecting low-income consumers.

Program financing assurances

Finding a sustainable solution to the public debt problem in line with our policy commitments stated in the MEFP of September 10, 2003 and the letter of intent of January 9, 2004, remains a priority of the government. The main elements of our approach aimed at reaching a collaborative agreement are: (i) to appoint banks to assist in preparations and help market the exchange offer; (ii) to hold additional meetings and engage in constructive negotiations with all representative creditor groups, including the Global Committee for Argentine Bondholders (GCAB), domestic institutional and retail holders such as the *Asociacion de Ahorristas de la Republica Argentina* (AARA), and European retail bondholder organizations such as the *Comitato Investori Titoli Argentini* (CITA); and (iii) to formulate the offer so that it will result in a sustainable debt for Argentina and would attain broad support from creditors.

We are making progress in these areas as follows:

- We have recently selected six banks to assist us in organizing and carrying forward the restructuring process. Three foreign investment banks will undertake marketing the exchange offer in foreign jurisdictions and three Argentine banks will undertake the non-institutional domestic portion of the restructuring. A presidential decree that gives legal status to their appointment will be issued before March 15, 2004. The banks are hired for nine months or until an exchange launch (whichever is the earlier). It is our clear intention to retain the banks through the entire restructuring process, subject to banks satisfying their contractual obligations.

- We will deal constructively and transparently with creditors and we will give due consideration to the initiatives that they may be willing to put forward. We have already invited 21 creditor groups to meet in Buenos Aires to continue the dialogue and have established a schedule for this purpose (see Annex I and accompanying invitation letters). We will also be intensifying the dialogue with domestic bondholders. By mid-April 2004 we will seek to reach agreement on a follow-up process and timetable. This framework will ensure meaningful negotiations with all creditor groups.

- We have started to formulate such a framework with the investment banks. This will facilitate the development of proposals as a means of reaching a collaborative agreement with creditors. Within such a framework, it is our intention to discuss with creditors all aspects of the debt exchange offer, including how best to optimize the elements of the offer taking into account the proposals received from creditors and the restrictions imposed by Argentina's debt burden. In tailoring the offer, we would take the necessary steps to maintain the principle of intercreditor equity and endeavor to avoid a piecemeal approach to the debt restructuring, in particular by finalizing with the assistance of the banks an appropriate minimum participation threshold necessary for a broadly supported restructuring.

We will discuss with the banks an appropriate timing for the launch of the offer. Given the need for consultations and additional discussions with creditors, it is difficult to set a precise timetable for launching and completing the exchange offer. At this stage, however, we believe that the offer would not be launched earlier than June 2004 and not later than August 2004.

The program is based on the World Bank and IDB maintaining their exposure to Argentina, which is key to protecting international reserves. We will continue to work closely with the multilateral development banks to ensure that their disbursements are closely in line with the program.

As regards Paris Club creditors, we intend to write to the Paris Club secretariat by mid-March 2004 to indicate the scope and type of treatment that we intend to seek.

Except as modified in this letter and the accompanying addendum to the TMU, the objectives, policies, targets and commitments of the economic program remain as described in the original MEFP of September 10, 2003 and our Letter of Intent of January 9, 2004.

In view of the progress made under the program, we request completion of the second review under the Stand-By Arrangement. As we implement our program, we will continue to maintain a close policy dialogue with the Fund and the rest of the international community.

Yours sincerely,

/s/	/s/	/s/
Dr. Roberto Lavagna	Lic. Guillermo Nielsen	Lic. Alfonso Prat-Gay
Minister of Economy	Finance Secretary	President of the Central Bank

The following letter was sent to all the creditor groups listed below on March 9, 2004

Buenos Aires, March 9, 2004

As stated in our letter of February 2004, we are pleased to invite you to Buenos Aires between March 24 and April 16.

We kindly request you to contact:

Lucía Aguirre (laguirre@mecon.gov.ar),
Leonardo Costantino (lcostan@mecon.gov.ar)
Adrián Nador (anador@mecon.gov.ar)
at 54.11.4349.8810 or at the following fax numbers 54.11.4349.8807 and 54.11.4349.8815 in order to set the date and time.

Yours truly,

Roberto Lavagna

LIST OF CREDITOR GROUPS INVITED TO BUENOS AIRES

1. Alliance
2. Altro Consumo
3. Asociacion de Ahorristas de la Republica Argentina
4. Asociacion de Damnificados por la Pesificacion y el Default
5. Capital Research
6. Comitato Investori Titoli Argentini (CITA)
7. Comitato per la Tutela degli Interessi e dei Diritti Dei Risparmiatori Privati Italiani Portatori di Quote del Debito Pubblico dello Stato Argentino
8. Comitato per la Tutela dei Risparmiatori Italiani Portatori di Titoli Obbligazionari della Republica Argentina
9. Daiwa Securities SMBC Co. Ltd.
10. Deutsche Bank
11. DekaBank
12. Fintech
13. Global Committee of Argentina Bondholders (GCAB)
14. Interessengemeinschaft Argentinien e.V (IGA)
15. JP Morgan Fleming
16. Mitsubishi Securities Co. Ltd.
17. Nikko Citigroup Limited
18. Nikko Cordial Securities Inc.
19. Nomura Securities Co. Ltd.
20. Sindacato Italiano Tutela Investimento e Risparmio (SITI)
21. Swiss Bankers Association (Swiss Banking)

ADDENDUM TO THE TECHNICAL MEMORANDUM OF UNDERSTANDING

All elements of the Technical Memorandum of Understandings (EBS/03/130, Attachment II) issued on September 12, 2003 remain in force, except for the revisions noted below.

I. QUANTITATIVE PROGRAM TARGETS

End-September performance criteria are being added for: (i) the cumulative primary balance of the federal government; (ii) the federal government debt stock; (iii) the stock of net international reserves of the central bank; and (iv) the stock of net domestic assets of the central bank, as follows:

Quantitative Performance Criteria and Indicative Targets
(In millions of Argentine *pesos* , unless otherwise noted)

	2004	
	Performance Criteria	Indicative targets
	End-Sep.	End-Dec.
Fiscal targets		
1 Cumulative primary balance of the federal government (floor)	8,020	10,240
2 Cumulative overall cash balance of the federal government (indicative target)	3,450	4,370
3 Federal government debt stock (ceiling, in billions of *pesos*) 1/	560	570
4 Stock of federal government arrears (indicative target)	3,970	4,660
5 Cumulative primary balance of the provincial governments (indicative target)	2,290	2,540
6 Consolidated public sector debt stock (indicative target, in billions of *pesos*)	584	594
Monetary targets		
7 Stock of net international reserves of the central bank (in millions of U.S. dollars) (floor) 1/	-3,300	-2,400
8 Stock of augmented monetary base (indicative target) 2/	49,625	53,805
9 Stock of augmented net domestic assets of the central bank (ceiling)	59,195	60,765
10 Consultation mechanism on projected end-2004 inflation (indicative target)		
Upper limit (in percent)	11.0	...
Lower limit (in percent)	7.0	...

1/ The following accounting exchange rates apply: Arg$/US$=2.9, US$/SDR=1.3875, Euro/US$=0.869, CAD$/US$=1.347, CHF/US$=1.351, JPY/US$=119.78, GBP/US$=0.604, Gold (U.S.$ per ounce)=371.0.
2/ Includes quasi-monies in circulation.

II. OTHER REVISIONS

- The following adjustor is added to the performance criterion on the stock of federal government debt (Section I). The debt ceilings will be adjusted:

  "g. Upward (downward) by the difference in the value of the "Argentine peso-denominated bond" maturing on September 19, 2008 calculated at the program exchange rate and the value of the bond calculated at the exchange rate specified in the original contract arising from the embedded option in the contract. This adjustment includes the valuation of interest arrears and interest payments on this bond."

- The continuous structural benchmark on below the line reporting (item (e) of Section III) is modified as follows:

  "The Secretaria de Hacienda and the BCRA will provide data from below-the-line on the financing flows of the provinces no later than 55 days after the end of the test date, or the following business day, if the 55th day falls on a Saturday, Sunday, or on a public holiday in Argentina."

  The requirement on the kind of information to be provided for this benchmark remains unchanged.

Statement by the IMF Staff Representative
March 22, 2004

1. The following information on recent developments and policy implementation has become available since the circulation of the staff report for the second review under the Stand-By Arrangement. The staff appraisal is unchanged.

I. RECENT DEVELOPMENTS

2. **Recent data releases point to continued robust economic activity and strong fiscal performance**.

- *Real GDP growth in 2003* has been revised upwards to 8.7 percent (from 8.4 percent).

- *Industrial production in February 2004* increased by 0.9 percent (14.1 percent year-on-year) led by strong increases in the automobile, publishing, and agro-chemical sectors. Capacity utilization is now about 70 percent, with sectors such as textiles close to full capacity.

- *The cumulative primary surplus of the federal government through February 2004* was Arg$2.5 billion (0.6 percent of GDP), significantly above the end-March 2004 performance criterion.

II. POLICY IMPLEMENTATION

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

- *Public debt restructuring*. On March 17, 2004, the authorities: (i) issued a presidential decree authorizing the appointment of six banks—three international and three domestic—to assist with the debt restructuring;[1] (ii) published the letter of engagement setting out the tasks of the banks; and (iii) invited an additional four creditor groups to Buenos Aires to begin negotiations on public debt restructuring (bringing the total of groups invited to 25).

    - The decree lays out the reasons for Argentina's decision to hire the banks and explains the fee structure, which appears to be broadly in line with previous sovereign debt restructurings and includes a "success fee" in the event that participation in the exchange exceeds two-thirds of the debt to be restructured.

[1] Issuance of the decree was a prior action for Executive Board consideration of the second review under the Stand-By Arrangement.

  - The tasks of the banks include providing advice on gathering market intelligence and communicating with investors, and assisting with the structuring of the new securities and managing the debt exchange. A condition of engagement is the authorities' cooperation in the process of negotiating with creditors. The authorities or the international management banks may terminate the engagement at any time.

- *Paris Club*. On March 15, 2004, the authorities wrote to the Paris Club Secretariat indicating that they were ready to negotiate a restructuring of official bilateral debt and would specify the scope and type of treatment being sought once the Paris Club agreed to enter into negotiations.

- *Banking strategy*. The central bank has issued two regulations to implement the banking strategy under the program:

  - On March 10, all banks were requested to submit multiyear business plans by end-March 2004.

  - On March 12, a regulation was issued to implement the compensation for asymmetric indexation. The regulation requires that banks submit by end-April 2004 detailed information on loans linked to the wage index. The central bank expects to credit escrow accounts with the compensation owed to all banks by June 2004 (proposed reset structural performance criterion).

- *Fiscal policy*. On March 10, the government issued a series of decrees that will raise cigarette-related excises and surcharges, effective April 1, 2004. The decrees establish a floor on tax collections from tobacco companies which would require gradual increases in cigarette prices by an estimated 20–30 percent over the next two years. The revenue yield is projected to be equivalent to 0.1 percent of GDP in 2004 and 0.3 percent in 2005, and to add about 0.3 percentage point to inflation over the next 12 months.

4. Fund approval of the Article VIII exchange restriction related to the *corralón* expired on March 19, 2004. Staff will recommend further approval of this restriction, which is scheduled to be eliminated in 2005. The request for approval will be included in the March 2004 Report on Delayed Completion of Article IV Consultations and Extension of Approval of Exchange Measures.

Press Release No. 04/57
FOR IMMEDIATE RELEASE
March 22, 2004

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Second Review of Argentina's Stand-By Arrangement

The Executive Board of the International Monetary Fund (IMF) today completed the second review of Argentina's performance under a three-year SDR 8.98 billion (about US$13.3 billion) Stand-By Arrangement that was approved on September 20, 2003 (see Press Release No. 03/160). Completion of the review will entitle Argentina to a disbursement equivalent to SDR 2.1 billion (about US$3.1 billion).

In completing the review, the Executive Board approved the modification of a structural performance criterion and a waiver for the nonobservance of a performance criterion.

Following the Executive Board's discussion of Argentina, Anne Krueger, Acting Managing Director and Chair, stated:

"Argentina's economy continues to recover rapidly, facilitating steady improvements in employment and poverty indicators. Progress is also being made in implementing reforms in key structural areas such as the banking system and the utilities sector. The authorities have indicated their willingness to negotiate with their private creditors with the aim of reaching an early comprehensive and sustainable sovereign debt restructuring.

"Disciplined macroeconomic policies have contributed to lifting consumer and investor confidence and have supported rapid economic growth. Monetary policy has kept inflation low and allowed interest rates to decline, while international reserves have recovered further in recent months. Looking ahead, the authorities recognize that monetary policy will need to take into account the narrowing output gap that could affect inflation expectations.

"Fiscal performance in 2003 was better than envisaged as a result of strengthened tax collections and restrained spending at the federal and provincial levels. These favorable trends are continuing in 2004 and afford considerable flexibility to the government to increase fiscal savings over the medium term as committed in their Letter of Intent, while also reducing distortive taxes and strengthening support of well-targeted social and capital projects.

"A number of important structural fiscal reforms are to be implemented in the coming months to strengthen the macroeconomic policy framework and address systemic weaknesses in the public finances. In particular, the federal government is working closely with provincial governors to secure an early political consensus on reforms to place intergovernmental financial relations on a permanent sound footing. These reforms aim to simplify the tax revenue-sharing arrangements, enhance incentives to raise own revenues, and introduce binding debt and deficit limits for provincial governments. Additional steps are to be taken to improve tax compliance for customs duties and social security contributions.

"In the banking area, there are welcome signs of return to overall profitability, and measures are being implemented steadily to reduce outstanding weaknesses in bank balance sheets, including by enhancing supervisory control through on-site inspections and the submission of banks' business plans. However, the authorities need to expedite the pending compensation payments to banks and to carry forward the agreed timetable for the strategic review and financial diagnostic of the two largest public banks.

"Some progress has been made with utility sector reform—including by initiating electricity and gas tariff increases for large users—but additional efforts are needed to improve the financial position of some of the regulated concessionaires. An important priority in this area is to develop a balanced regulatory framework that will facilitate the process of renegotiation of concessions of public services and encourage new private investment in the sector, while protecting lower income groups from tariff increases.

"The authorities' commitment to reach a collaborative agreement with their private creditors on a sovereign debt restructuring is welcome. The main elements of the authorities' framework include: (i) appointing investment banks throughout the restructuring process to assist in preparations and help market the debt exchange offer; (ii) engaging in constructive negotiations with all representative creditor groups; and (iii) formulating an offer that will result in a sustainable debt for Argentina and attain broad support from creditors. The authorities have already implemented elements of this agreed debt restructuring strategy: three international and three domestic investment banks were appointed and the terms of their engagement were disclosed; and 25 representative creditor groups were invited to hold separate discussions in Buenos Aires during March 24–April 16, 2004. The groups invited include the Global Committee for Argentine Bondholders, domestic institutional and retail holders such as the *Asociacion de Ahorristas de la Republica Argentina,* and European retail bondholder organizations such as the *Comitato Investitori di Titoli Argentini.* The authorities will endeavor to avoid a piecemeal approach to the debt restructuring and intend to finalize, with the assistance of their investment banks, an appropriate minimum participation threshold necessary for a broadly-supported restructuring.

"Consistent implementation of this debt restructuring framework will be essential for the continued support of the international community. In particular, the authorities' intention to discuss with creditors all aspects of the debt exchange offer, including how best to take into account proposals received from creditors, is crucial. The authorities are encouraged to work diligently to design a debt exchange offer that attains the highest possible creditor participation, reduces the risk of protracted litigation, and restores debt sustainability," Ms. Krueger said.

Statement by Hector Torres, Alternate Executive Director for Argentina
March 22, 2004

1. At the outset I wish to express to management and staff the appreciation of my authorities for their efforts in reaching an agreement and in recommending to the Board the approval of this second review which will help to consolidate the progress achieved so far and to establish firmer basis looking forward.

2. As we are all aware, some quarters of the international financial community have called into question the preferred creditor status of the Fund and the rest of the International Financial Institutions (IFI). Let me ratify, once more, that Argentina is a member in good standing of the international financial community and, as such, adheres fully to the preferred creditor status of the IFIs. The commitment of my authorities to honor the preferred status of the IFIs has been unambiguously proven by the almost US $ 7 billion in negative transfers to these institutions since the beginning of the crisis in January 2002. Moreover, the latest payment made on March 9 implied applying approximately 20 percent of Argentina's reserves. This payment was made without knowing whether this meeting would be approving the second review of the arrangement between the Fund and Argentina. It was made in good faith and demonstrates that my authorities are committed to respect the Fund's preferred creditor status.

3. The growth momentum of the Argentine economy continues to be strong, encompassing practically all areas of economic activity. Sound macroeconomic policies, a favorable external environment, the high degree of popular support for the government in the context of a smooth political transition have all contributed to strengthen investors and consumer confidence that is, in fact, the real underpinning of economic activity in Argentina these days. It is worth noting that the consumer confidence index, as measured by the Torcuato Di Tella University, has reached in February a historically high record level. Even the banking system which has been one of the areas more affected by the December 2001 crisis is showing signs of renewed strength. The government has compensated banks for the impact of asymmetric pesoisation and is in the process of doing so with regard to asymmetric indexation. The recovery of the banking system over the medium term will, nonetheless, be predicated on a return to profitability in the context of a renewed confidence both on the part of depositors and of the banks in their willingness to grant new loans. Both these developments are, in fact, already starting to take place. All of this gives firm basis to expect that the strong performance of 2004, with a real GDP growth rate estimated at 8.7 percent, will become a sustained growth process looking forward. In this regard, my authorities have already adjusted upward the growth initially projected for this year to 5 ½ percent, a figure that is still in the lower end of many private forecasters.

4. These positive expectations are also reflected in the bond and stock markets. Financial assets prices are observing an increasing trend since late 2002. The Buenos

Aires Stock Market Index, Merval, which in that date was hovering around the 700 value, is now at around the 1250 level, which in dollar terms represents an even higher increase due to the slight appreciation of the peso during the period.

5. A very encouraging development is taking place in the labor market with employment data reported for the fourth quarter 2003 indicating an unemployment rate of 14.1 percent, almost 2 percentage points lower than the third quarter 2003 and almost 10 percentage points lower than the second quarter of 2002, at the peak of the crisis. This is even more remarkable since it has happened in the context of an increasing labor market participation rate. This confirms the continued strength of domestic demand and, in particular, private consumption and private investment in accord with higher real incomes and employment levels. In spite of these encouraging developments, addressing the social consequences of the unprecedented crisis will require persistent and sustained fiscal efforts. In this respect, let me remark that the aforementioned unemployment figures reflect around 4 percent of employment due to the government-run program "Plan Jefes y Jefas de Hogar", although this percentage has been declining, due to the incorporation of more beneficiaries to regular employment.

6. The external environment, in turn, continues to be favorable and it could be compounded by the expected recovery of activity in Brazil which will translate into a very positive spillover to the growth dynamics in Argentina. In spite of the current positive external environment, Argentina remains vulnerable to unfair trade competition. My authorities are deeply concerned with the lack of progress in the current negotiations taking place at the World Trade Organization. Commodity prices are currently strong enough to, at least partially, absorb the consequences of massive subsidization to agricultural production in G7 countries. However, if the cycle of prices happens to turn down, as it periodically does, export and production subsidies would have a pro-cyclical effect on prices declines. This will compound the dramatic consequences for developing countries. that as Argentina, have no fiscal means nor the willingness to enter into the folly competition of wealthy treasuries.

7. As described in the staff report, all fiscal and monetary targets of the program have been met with wide margins. Revenues are being sustained not only by the strength of the economy but also by fiscal austerity and by a much improved fiscal administration aimed at combating tax evasion. Further measures are being prepared to improve compliance in the areas of custom duties and social security contributions. On the expenditures side a continued control, in particular over wages, is also contributing to achieve levels of primary surplus beyond those committed in the program. This represents a considerable effort considering the hardship faced by the Argentine people after the crisis which resulted in having over 50 percent of the population under the poverty line and over 25 percent under the extreme poverty line.

8. The fiscal austerity combined with improved tax collection has set the right conditions for addressing the structural fiscal reforms expected in the program. starting with the reduction of the distortionary financial transaction tax by July 2004 and with a more comprehensive tax reform legislation to be submitted to Congress by

end-September 2004, along with the 2005 budget. Finally, on the structural fiscal reform area. important progress has been made in the formulation of the main elements of the new law regulating the intergovernmental revenue-sharing agreement, aimed at encouraging budgetary discipline in provincial governments and to simplify the present system which is plagued with numerous and disconnected schemes and regulations that impair transparency and that make more difficult to achieve an equitable distribution of revenues among provinces.

9. In the monetary front, as also described in the report, all monetary targets were met with large margins. Despite the continued accumulation of international reserves, the low interest rates and the fact that all quasi-monies have been removed from circulation, twelve-month consumer price inflation remains subdue and fell to 2.3 percent in February. This contrasts with the modest increase foreseen in the September 2003 agreement. Inflation in 2004 has, consequently, been adjusted downward. Staff makes the point that wholesale price inflation has begun to pick up. This is largely due to the strength in commodity prices in particular soybean and oil, which are determined in international markets. Notwithstanding the low interest rates, banks deposits are growing steadily and so is the demand for Central Bank paper Lebacs, all of which points to a strong increase in the demand for money. This, along with the very low inflation, could justify a relaxation of the monetary base for the upcoming reviews.

10. On the banking system it is worth noting that total deposits grew 19 percent in real terms during 2003. At the same time, a clear reversal of trend was observed in terms of profitability with the last quarter showing positive results. Credit to the private sector has also increased, in particular, for consumer loans. Non-performing loans continue to show a declining trend with clear improvements in the consumers portfolio. This will help to reduce charges for non-performing loans thus supporting profitability. In the same vein, the upcoming reduction in the financial transactions tax and the restructuring of the non-performing debt will serve to improve banks' income and profitability results. It is also worth noting that there has been an important reduction in administrative expenditures which will also contribute to consolidate that trend. The reintroduction in January of the capital adequacy regime has been safely absorbed by most banks, which were already building up capital during 2003 through debt capitalizations and debt cancellations with public bonds. In fact, most banks already count with capital adequacy ratios above the required minimums. The latter downplays the impact of the lower compensation that some of them will receive, alluded to in Box 3 of the report, due to a more accurate assessment of what is due to them because of asymmetric pesoisation and indexation.

11. Notwithstanding the involuntary delay in the launching of the bids to select the financial advisors that will undertake the due diligence and strategic reviews of Banco de la Nacion and Banco de la Provincia de Buenos Aires and the consequent postponement of the actual selection of the advisors to end-June 2004, the date for the completion of the action plans for strengthening these major public banks will only

suffer a small delay vis-à-vis the date set at the time the program was approved in September last year, and is now expected by end-December 2004.

12. My authorities are very pleased with the progress achieved with the restructuring of the private corporate debt which has demonstrated that the existing insolvency framework is sufficiently flexible to address complex cases. More importantly, it has proven that the position taken by my authorities that no public funds would be used to bail out the corporate sector was correct, since it has not impeded the restructuring of corporate debt through mutually satisfactory solutions.

13. On the utility sector reform, several important developments have taken place. In the first place, it is important to highlight that notwithstanding the delay in price adjustment most companies are showing positive operational balances. Secondly, upward adjustment in tariffs has already started with an increase in the electricity and gas tariffs for large size non-residential consumers of between 10-35 percent. Beyond this, the joint fact-finding mission of Bank-Fund staff. that took place last month. has already issued its preliminary conclusions. As a result, a renewed dialogue with the authorities has started, which will allow for a more active exchange of information that will facilitate the reform process of the utility sector with a view to renegotiate the concessions in a timely and efficient manner. In addition, it will help to ensure consistency of the new concessions with the regulatory framework that is under discussion. A right balance between the legitimate companies' goal to obtain profits with the social aspect involved in the type of service these companies provide will need to be stricken.

14. The logic that investment will not back up continued growth if the non-performing debt problem is not previously solved is questioned by the fact that investment is already flowing into the economy as the strong growth in imports of machinery and equipment proves. It goes without saying that a successful restructuring of non-performing debt would underpin the sustainable path of growth and my authorities are committed to seek, in good faith, an agreement with private creditors. There should be no doubt in this respect. However, Argentina would do a very poor favor to itself and to the international community if, in order to meet sectoral interests, it was to assume commitments that could not be fully honored over the medium-term. Accepting an excessive debt service that could jeopardize economic and social recovery would only bring more instability to the region and to financial markets. Argentina will only accept debt restructuring commitments within its reach to honor. Good faith requires a government to act responsibly and with due diligence. In this respect, it may be illustrative to recall that both the French civil law and the German law support the view that a "careless promisor", namely a party making promises that are unlikely to be fulfilled, would be acting with "lack of diligence" or in bad faith. Thus, if my authorities were to advance, as some seem to expect, an attractive but knowingly unsustainable debt restructuring proposal, this would configure a "careless promisor" conduct and result in a breach of to their obligation to negotiate in "good faith".

15. As we explained earlier, the Argentine authorities face compelling social imperatives. These social imperatives configure a different type of debt. Over 50 percent of Argentina's population is living in poverty, out of which 50 percent endures extreme poverty. My authorities are committed to address both the country's sovereign and the social debt and will do so in full respect to the undertakings contained in the LOI of September 10, 2003. To do so, their strategy is to consolidate a process of sustained growth predicated on responsible macroeconomic and structural policies, including through the strengthening of governance, the rule of law and the consolidation of political democracy and social stability. Calls for larger primary surpluses should be evaluated responsibly and with due consideration to the additional economic and social hardships that enlarging the primary surplus would impose on a country that has not yet emerged from its deepest crisis in the last century. In any event, primary surpluses are only one aspect of the payment capacity equation. In the view of my authorities, only achieving sustained growth would allow to maximize payment capacity over the medium term. Argentina can only count on its own resources to restructure non-performing debt. Every payment will come out from one single pocket. Allowing Argentina to recover will be for the benefit of all. It is in this philosophy that my authorities will propose to create partnerships with those private creditors willing to link actual payments to the GDP growth rate.

16. As indicated in the LOI, on March 15 President Kirchner signed the decree designating the syndicate of international and domestic banks that will help the authorities to define the basic features of a proposal that will finally be presented to private creditors in the form of a bond exchange offer. The restructuring process is already launched. On March 22 and 23, intensive kick-off meetings between my authorities and the six designated investment banks are scheduled. A long list of constructive negotiations, with all representative creditor groups will follow in the coming weeks. This will be a bilateral process between Argentina's authorities and creditor's representatives. External interference will not be helpful to the process. My authorities are frustrated to see that in the paper prepared by the staff (EBS/04/38 Supplement 1) only one group of creditors is specifically mentioned. No representative creditor group will be excluded from the restructuring process. My authorities are confident that the Fund will keep clear from getting involved in the negotiations between creditor groups and Argentina.

17. Regarding Paris Club creditors, my authorities have indicated that they are ready to hold negotiations at any time. Negotiations have not yet started because some members of the Paris Club have requested for some additional time to start the negotiations with Argentina.

18. In closing, my authorities are fully committed to a successful implementation of the present Stand-By arrangement with the Fund, which is offering the proper macroeconomic and structural framework to predictably advance the process of debt restructuring, as well as the reforms in the banking and utilities sectors, all of which are also important elements to achieve sustained growth over the medium-term, a

necessary condition to address the widespread social needs of the Argentine people. As President Kirchner stated in his message to Congress, inaugurating this year's ordinary sessions, "Our strategy to face these problems should be that of building up a serious capitalism... where monopolies and concentration are avoided... and where consumers as well as investors are protected"