IMF Country Report No. 16/346

# ARGENTINA

November 2016

## 2016 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR ARGENTINA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2016 Article IV consultation with Argentina, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its November 9, 2016 consideration of the staff report that concluded the Article IV consultation with Argentina.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on November 9, 2016, following discussions that ended on September 30, 2016, 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 October 19, 2016.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staff of the IMF.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for Argentina

The documents listed below have been or will be separately released:

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

**International Monetary Fund**
**Washington, D.C.**

Press Release No. 16/500
FOR IMMEDIATE RELEASE
November 10, 2016

International Monetary Fund
Washington, D.C. 20431 USA

**IMF Executive Board Concludes Article IV Consultation with Argentina**

On November 9, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV Consultation with Argentina.[1]

Upon taking office in December last year, Argentina's new government faced pervasive macroeconomic imbalances, microeconomic distortions, and a weakened institutional framework. Confronted with this difficult situation, the authorities began an ambitious and much needed transition toward a better economic policy. Important progress has been made already in 2016. The peso is now market determined and exchange controls have been essentially eliminated. The increase in utility tariffs has brought prices more in line with underlying costs. The settlement with creditors has allowed a return to international capital markets by both the private and public sector. Medium-term fiscal and inflation targets have been announced in conjunction with a transition toward a modern system of inflation targeting. Finally, the national statistics agency is being rebuilt, allowing for the publication of improved and credible statistics.

The reversal of the serious imbalances and distortions inherited from the previous administration, while necessary to lay the foundation for robust future growth, unavoidably had an adverse near-term impact on the Argentine economy. However, the current recession had begun even before the new administration took office and the alternative of continuing with the unsustainable policy framework of the past administration was simply not tenable, as it would have eventually led to a repeat of Argentina's history of crisis, contraction, and social distress. The economy is expected to rebound from a -1.8 percent recession in 2016 to a 2.7 percent growth in 2017, and to grow at a close to 3 percent pace over the medium term. A modest headwind from the planned fiscal rebalancing should be offset by a pickup in private consumption (as inflation continues to fall), an improving external environment, and

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. The last Article IV Consultation with Argentina took place about 10 years ago, in July 2006.

a rebound of private investment. With strong policy action and dramatic changes underway in the Argentine economy, the outlook is subject to greater than normal uncertainty.

Against this background, the central focus of the Article IV Consultation was on the best way to restore sustained and equitable growth, boost job creation, and protect the poor from the costs of restoring macroeconomic stability

The government has been clear in its commitment to bring inflation to single digit levels by 2019, and has maintained real interest rates broadly constant in positive territory while lowering the policy rate since Spring this year as forward looking indicators of inflation began to fall. A tight control of spending growth in the first few months of the year is expected to allow the federal government to meet the primary fiscal deficit objective for 2016 (4.8 percent of GDP), despite injecting some fiscal stimulus in the second half of the year. The 2017 Budget envisages a modest reduction of the primary federal fiscal deficit for next year, to 4.2 percent of GDP, mainly on account of further cuts of energy subsidies. Over the last few months, progress on structural reforms has occurred in the areas of governance, anti-corruption, competition policies, and financial market infrastructure, but supply-side bottlenecks remain that might impede a faster rebound of private investment and productivity.

**Executive Board Assessment**

Executive Directors strongly welcomed Argentina's resumption of the Article IV consultation and underscored the importance of close engagement between the authorities and staff going forward.

Directors commended the ambitious reforms taken by the new administration to ensure a more stable and sustainable economic policy framework. They cautioned that reversing the legacy of severe macroeconomic imbalances, pervasive microeconomic distortions, and a weakened institutional framework will take time, but noted that important progress has been achieved by the authorities. While the measures taken have had a negative short-term impact on economic activity, the Argentinian economy is expected to rebound in 2017. Directors encouraged the authorities to remain steadfast in their reform efforts and reach out to stakeholders to secure broad support.

Directors stressed that continuing to lower the fiscal deficit is an important part of the adjustment. They noted that the pace and composition of rebalancing should be sensitive to its impact on growth, jobs, and the most vulnerable segments of the population, while maintaining clear medium-term objectives. In this context, Directors broadly saw the gradual reduction of the fiscal deficit envisaged by the authorities to be appropriate. At the same time, some Directors considered that the pace of deficit reduction could be accelerated if economic activity was stronger than expected, including to facilitate the reduction of inflation.

Directors emphasized the importance of institutional reforms to improve the efficiency and credibility of the fiscal framework. These reforms include introducing a simple and transparent medium-term fiscal policy plan; rationalizing government spending, including the wage bill; removing poorly targeted and distortionary energy subsidies; and restoring financial sustainability to the pension system. Directors also noted the need to make the tax system more progressive over time to reduce the tax burden and make the system more efficient. They also highlighted the importance of addressing issues related to fiscal federalism.

Directors commended the authorities' efforts to bring down inflation to single digits. They broadly agreed that the pace at which inflation is reduced should remain attuned to its economic costs and distributional impact. Directors emphasized that building credibility in the monetary framework—in particular, establishing a clear price stability mandate for the central bank and securing its operational independence, and eliminating monetary financing of the deficit—will lessen the economic and social costs of disinflation.

Directors called for an ambitious agenda of supply-side reforms to improve the business climate and achieve strong, sustained and equitable growth. They noted that priorities include promoting competition, putting in place a better regulatory framework for energy and utilities, fully realigning utility tariffs toward cost recovery, and instituting a transfer scheme to protect the poor. Measures to gradually improve the quality of infrastructure, lower trade barriers, and develop local capital markets would also help. Directors welcomed recent progress to fight corruption, scale back government involvement in private industries, and create a better governance framework.

# Argentina: Selected Economic and Financial Indicators

| | Average 2009–14 | 2015 | Proj. 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|
| | *(Annual percentage changes unless otherwise indicated)* | | | | | | | |
| **National income, prices, and labor markets** | | | | | | | | |
| GDP at constant prices | 1.5 | 2.5 | -1.8 | 2.7 | 2.8 | 2.9 | 3.1 | 3.3 |
| Domestic demand | 2.6 | 3.7 | -2.2 | 3.4 | 3.6 | 3.6 | 3.5 | 3.6 |
| Consumption | 2.8 | 4.1 | -1.8 | 2.3 | 2.7 | 2.7 | 2.9 | 3.0 |
| Private | 2.6 | 3.6 | -1.7 | 2.5 | 2.8 | 2.8 | 3.0 | 3.1 |
| Public | 4.5 | 6.6 | -2.5 | 1.6 | 2.1 | 2.4 | 2.5 | 2.5 |
| Investment | 1.6 | 4.2 | -3.6 | 8.2 | 7.2 | 7.2 | 5.9 | 5.8 |
| Exports | -1.0 | -0.6 | 4.5 | 4.4 | 4.8 | 3.8 | 5.5 | 4.8 |
| Imports | 4.4 | 5.6 | 1.3 | 6.8 | 7.6 | 6.3 | 6.3 | 5.6 |
| Change in inventories and stat. disc. (contribution to growth) | 0.1 | -0.3 | -0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Nominal GDP (billions of Argentine pesos) | 2,609 | 5,843 | 8,043 | 10,173 | 12,466 | 14,801 | 17,016 | 19,259 |
| CPI inflation (eop, y/y percent change) | ... | ... | 39.4 | 20.5 | 17.5 | 13.0 | 10.3 | 9.4 |
| Unemployment rate (percent) | 7.5 | ... | 9.2 | 8.5 | 8.3 | 7.5 | 6.9 | 6.8 |
| | *(Percent of GDP unless otherwise indicated)* | | | | | | | |
| **External sector** | | | | | | | | |
| Exports f.o.b. (goods, billions of U.S. dollars) | 71.9 | 56.8 | 55.3 | 57.2 | 59.5 | 62.0 | 65.6 | 68.9 |
| Imports f.o.b. (goods, billions of U.S. dollars) | -60.1 | -57.2 | -51.6 | -56.4 | -61.1 | -65.5 | -70.2 | -74.5 |
| Trade balance (goods, billions of U.S. dollars) | 11.7 | -0.4 | 3.8 | 0.8 | -1.5 | -3.5 | -4.5 | -5.6 |
| Trade balance (goods) | 2.6 | -0.1 | 0.7 | 0.1 | -0.2 | -0.5 | -0.6 | -0.7 |
| Terms of trade (percent change) | 1.6 | -4.0 | 2.3 | -2.9 | -1.6 | -0.4 | -0.4 | -0.2 |
| Total external debt | 31.4 | 25.2 | 31.7 | 32.5 | 33.8 | 34.5 | 34.6 | 34.6 |
| **Savings-Investment balance** | | | | | | | | |
| Gross domestic investment | 16.3 | 15.9 | 15.8 | 16.5 | 17.1 | 17.6 | 17.9 | 18.2 |
| Gross national savings | 15.9 | 13.4 | 13.5 | 13.3 | 13.5 | 13.7 | 13.9 | 14.0 |
| Current account balance | -0.4 | -2.5 | -2.3 | -3.2 | -3.6 | -3.9 | -4.0 | -4.2 |
| **Public sector 1/** | | | | | | | | |
| Primary balance | -1.7 | -5.4 | -5.6 | -5.1 | -4.1 | -3.0 | -2.0 | -1.8 |
| *of which*: Federal government | -1.4 | -5.0 | -4.8 | -4.5 | -3.6 | -2.5 | -1.4 | -1.3 |
| Overall balance | -2.7 | -6.6 | -7.3 | -6.9 | -6.2 | -5.0 | -3.8 | -3.6 |
| *of which*: Federal government | -2.4 | -6.2 | -6.5 | -6.3 | -5.6 | -4.4 | -3.2 | -3.0 |
| Revenues | 30.7 | 34.0 | 32.5 | 32.3 | 32.2 | 32.0 | 31.8 | 31.7 |
| Primary expenditure | 33.1 | 39.4 | 38.0 | 37.4 | 36.3 | 35.0 | 33.8 | 33.5 |
| Total public debt (federal) | 43.3 | 52.1 | 51.8 | 51.1 | 51.2 | 50.0 | 48.4 | 47.5 |
| **Money and credit** | | | | | | | | |
| Monetary base (eop, y/y percent change) | 27.5 | 34.9 | 24.4 | 23.7 | 20.7 | 16.5 | 13.8 | 12.8 |
| Credit to the private sector (eop, y/y percent change) | 28.9 | 35.6 | 26.4 | 21.2 | 18.4 | 14.8 | 15.3 | 14.0 |
| Credit to the private sector real (eop, y/y percent change) | ... | ... | -9.3 | 0.6 | 0.8 | 1.6 | 4.5 | 4.2 |
| LEBAC interest rate (average) 2/ | 16.0 | 28.1 | 29.8 | 25.2 | 20.1 | 16.3 | 13.7 | 13.1 |
| LEBAC real interest rate (average) 2/ | ... | ... | 5.0 | 5.1 | 4.4 | 4.4 | 3.7 | 3.4 |
| LEBAC interest rate (eop) 2/ | 16.3 | 32.2 | 28.3 | 22.8 | 17.7 | 15.1 | 13.2 | 13.0 |
| LEBAC real interest rate (eop) 2/ | ... | ... | 6.4 | 4.5 | 4.2 | 4.4 | 3.5 | 3.3 |
| **Memorandum items** | | | | | | | | |
| Gross international reserves (billions of U.S. dollars) | 42.0 | 25.6 | 33.3 | 36.5 | 49.2 | 56.5 | 61.2 | 66.6 |
| Exchange rate (eop, Arg$/US$) | 5.3 | 13.0 | ... | ... | ... | ... | ... | ... |
| Change in REER (average, percent change) | 6.7 | 26.0 | -12.8 | 3.7 | 2.9 | 2.9 | 2.9 | 2.9 |
| Transfers from BCRA | 0.9 | 1.3 | 1.4 | 0.6 | 0.2 | 0.1 | 0.0 | 0.0 |

Sources: Ministerio de Hacienda y Finanzas Públicas, Banco Central de la República Argentina (BCRA), and Fund staff estimates.

1/ The primary balance excludes profit transfers from the central bank of Argentina. Interest expenditure is net of property income from the social security fund.

2/ Average of LEBAC rates of all maturities.

# ARGENTINA

## STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION

October 19, 2016

## KEY ISSUES

**An inherited legacy of imbalances**. Upon taking office in December last year, Argentina's new government faced pervasive macroeconomic imbalances, microeconomic distortions, and a weakened institutional framework. These encompassed unsustainably high consumption levels, historically low levels of investment, and large fiscal deficits financed by money creation, which led to high inflation. Distortions at the micro level included an extensive network of administrative controls (for example, trade barriers, foreign exchange restrictions, and price controls) and a business environment that eroded competitiveness and undermined medium-term growth. There was also an important weakening of the institutional framework for economic policymaking, perhaps most evident in the loss of credibility of the national statistics agency.

**Initial policy steps**. Confronted with this difficult situation, the new government began an ambitious and much needed transition toward a better economic policy framework, reversing the serious macroeconomic imbalances and microeconomic distortions inherited from the previous government. Important progress has been made. The peso is now market determined, and foreign exchange controls have essentially been eliminated. The increase in utility tariffs has brought prices more in line with underlying costs. The settlement with creditors has allowed a return to international capital markets by both the private and public sectors. Medium-term fiscal and inflation targets have been announced in conjunction with a transition toward a modern system of inflation targeting. Finally, the national statistics agency is being rebuilt, allowing for the publication of improved and credible data on inflation, trade, the labor market, and output.

**Prospects**. The reversal of the serious imbalances and distortions inherited from the previous administration, while necessary to lay the foundation for robust future growth, unavoidably had an adverse near-term impact on the Argentine economy. However, the alternative of continuing with the unsustainable policy framework of the past administration was simply not tenable, as it would have eventually led to a repeat of Argentina's history of crisis, contraction, and social distress. The economy is expected to emerge from recession in 2017 and grow at a close to 3 percent pace over the medium term. A gradual rebound of private investment is forecasted as fiscal imbalances and inflation are reduced and supply side reform proceeds. High gross external financing needs and an overly backward looking process for wage inflation represent negative risks to the outlook. However, the better policy framework could trigger a stronger rebound in private investment creating an important upside for growth.

**Macroeconomic policy mix**. The way forward for Argentina is to restore balance to the fiscal accounts and deploy monetary policy to steadily bring down inflation. Getting the balance right in this policy mix will be complex but critical. Frontloading the reduction of the fiscal deficit to the extent allowed by the current economic, political, and social constraints would allow for a more accelerated reduction in interest rates, ease the upward pressure on the real exchange rate, improve the public debt dynamics, and facilitate the needed rebalancing from consumption to investment.

**Institutional reforms**. Rebuilding the institutional framework for good policies will significantly ease the economic cost of the transition. This includes securing the operational independence of the central bank and anchoring expectations through simple and transparent medium-term fiscal objectives. Strengthening public expenditure management and increasing the efficiency of public spending would create space for a needed reduction of the tax burden and for measures to alleviate the impact of the transition on the poor. Supply-side priorities include putting in place a better regulatory framework for energy and utilities, fully realigning utility tariffs toward cost recovery, and instituting a transfer scheme to protect the poor. There is also a broader need to scale back government involvement in private industries and creating a better governance framework, including by making further progress on the government’s ambitious anti-corruption plans. Such a set of policies will create an environment that is more conducive to private investment and will generate significant medium-term dividends in terms of more and better jobs as well as a steady improvement in the living standards for Argentina’s population.

Approved By
**Nigel Chalk (WHD) and Mary Goodman (SPR)**

The staff team comprising R. Cardarelli (head), L. Lusinyan, J. Canales-Kriljenko, D. Singh (all WHD), M. Ortiz Villafañe (WHD, local economist), P. Dudine (FAD), L. Jacome (MCM), A. Pienkowski (SPR), Ch. DeLong, and F. Figueroa (both LEG) visited Buenos Aires and Cordoba during September 19–30, 2016. J. L. Saboin (WHD) provided research assistance. Mr. Werner (WHD) joined the concluding meetings. Mr. Torres (OED) participated in the meetings. The mission met with senior officials and representatives of private sector, finance industry, academics, and think-tanks.

# CONTENTS

## TABLES



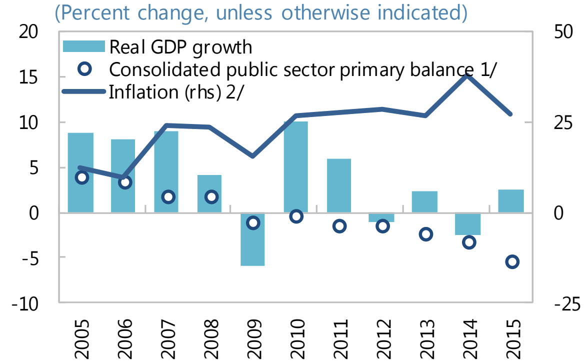
## ANNEXES

# 2006–15: A LEGACY OF UNBALANCED GROWTH

1. **The last IMF Article IV Consultation with Argentina took place in 2006, just as the rebound from the 2002 crisis was beginning to run out of steam**. The 2001–02 crisis was one of the worst economic recessions any country has ever suffered. It left scars on the social, political, and economic fabric of Argentina. About one million jobs were lost, unemployment rose to 21 percent, and poverty jumped to over 50 percent of the population. By 2003, an undervalued exchange rate, high and rising international prices for Argentina's key exports, and the significant reduction in debt service payments that followed the default fostered a fast economic rebound. However, by the mid-2000s, the economy was showing signs of internal strains, overheating, and rising inflation. At the same time, supply-side weaknesses, including an increasingly interventionist role of the government and important relative price distortions, were eating into growth potential.

**Key Macroeconomic Developments**

(Percent change, unless otherwise indicated)



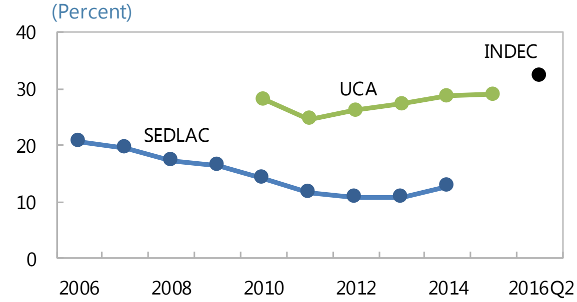

Sources: INDEC, Ministerio de Hacienda, Government of the City of Buenos Aires, private think tanks, and Fund staff calculations.

1/ Percent of GDP; 2/ Staff estimates based on the INDEC IPC-GBA until 2006, private estimates of inflation from 2006 and 2012, and CPI published by the City of Buenos Aires thereafter.

2. **Faced with declining growth prospects, the government supported the economy through expansionary macroeconomic policies**. A tailwind of high commodity prices and strong demand for Argentine exports, particularly from China, helped. Despite this, macroeconomic imbalances grew as sizable primary surpluses turned to deficit, and monetary financing pushed inflation upwards (although official statistics showed unrealistically low inflation). By 2012, the terms of trade moved against Argentina revealing the full extent of the underlying imbalances that included an overvalued real exchange rate, high inflation, and a steady decline in international reserves. To hold together the inconsistent and unsustainable policy mix, the authorities progressively deepened administrative controls, including trade barriers, foreign exchange (FX) controls (which led to a parallel exchange market), price controls, and pervasive distortions in both markets and incentives. Even with these efforts, the economy moved into recession in late 2015 with inflation ending the year at 27 percent (based on the City of Buenos Aires CPI).

3. **The new government, which took office in December 2015, inherited an inconsistent and distorted economic model**. The policies of the past decade had pushed consumption to unsustainable high levels, eroded potential growth and international competiveness, resulted in one of the lowest investment rate among emerging market economies, and left Argentina close to a balance of payment crisis with international reserves virtually exhausted. In addition, the good progress made in reducing poverty and income inequality in the years following the 2001 crisis had moved into reverse after 2011 and, by mid-2016, 32 percent of the urban population were living below the poverty line (see Box 1).

**Poverty Rate 1/**
(Percent)



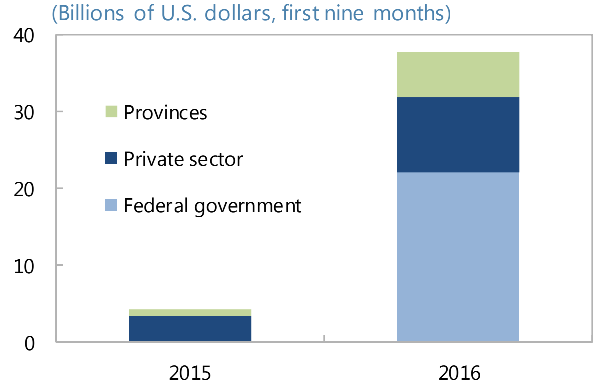

Sources: Pontificia Universidad Católica Argentina (UCA), SEDLAC (CEDLAS and World Bank), and INDEC.
1/ Poverty line is US$4 per day for SEDLAC and is based on a consumption basket for INDEC and UCA.

# 2016: A WELL-MANAGED AND NECESSARY TRANSITION

4. **In the first few months of the new administration, bold steps were taken to**:

- Remove the various FX controls and let the exchange rate float, unifying the official and parallel exchange markets, and correcting the overvaluation of the peso through a 40 percent depreciation of the official rate in December 2015.
- Announce a plan of fiscal consolidation to reach a zero primary balance by 2019.
- Announce an inflation target of 20–25 percent for end-2016, falling to 5 percent by end-2019, and begin the transition towards an inflation-targeting regime.
- Regain access to international capital markets by reaching a settlement with creditors. This allowed the federal government, provinces and private corporations to issue about US$37.8 billion in bonds in global markets so far in 2016 (US$9.5 billion of which were used to finance the agreement with holdout creditors).
- Raise utility tariffs, especially in the Buenos Aires metropolitan area by an average of 250 percent for electricity and subsequently by a 100–300 range for natural gas, water and transportation. The most vulnerable were protected through a social tariff that allowed one fifth of the consumers to receive a fixed amount of free electricity and a significantly subsidized tariff for natural gas.

**Debt Issuance in International Markets**
(Billions of U.S. dollars, first nine months)




Sources: BCRA and Fund staff estimates.

## Box 1. Poverty in Argentina

The data on poverty published by the national statistics agency (INDEC) in September 2016 after 3 years of suspension show that, as of mid-2016, 32.2 percent of Argentina's urban population (about 8.8 million people) lives below the poverty line (defined as the level of income needed to satisfy essential necessities for food, clothing, transportation, education, health). Moreover, 6.3 percent (1.7 million people) of the population lives in extreme poverty (with income below what is needed to satisfy basic food necessities). The data stand in stark contrast to the last published statistic, according to which the poverty rate in Argentina was 4.7 percent in the first half of 2013.

**Argentina: Poverty Rate**
(Percent, 2016Q2)

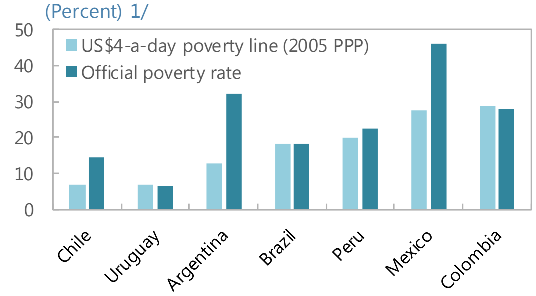
| | Poverty | Extreme poverty |
|---|---|---|
| Total (persons) | 32.2 | 6.3 |
| by age group | | |
| 0–14 | 47.4 | 9.4 |
| 15–29 | 38.5 | 8.0 |
| 30–64 | 27.5 | 5.0 |
| 65 and above | 8.0 | 1.3 |

Sources: INDEC and Fund staff calculations.

The new data released by INDEC also show that about 23 percent of Argentine *households* (about 2 million) lives below the poverty line, with their income being on average about 37 percent below the poverty threshold (12,850 pesos or about US$900 per month). About 5 percent of households lives in extreme poverty, with an income that on average is 40 percent below the threshold (4,930 pesos or about US$350 per month). The geographical distribution shows that poverty is particularly high in the Northeast of the country, where the household poverty rate is about 30 percent, compared to slightly below 20 percent in the southern (Patagonica) region. The poverty picture is particularly worrisome when looking at the age distribution, with about 47½ of children living in poverty and nearly one in ten children in extreme poverty. By contrast, only 8 percent of the elderly population lives in poverty.

While different national definitions and data availability make it difficult to compare poverty rates across countries, based on official indicators Argentina's rate is among the highest in the region. Based on standardized World Bank/CEDLAS estimates of poverty rates (defined as the share of population living with less than US$4 per day) reveals that, using this definition, in 2014 poverty in Argentina was higher than in Chile and Uruguay but lower than Brazil, Mexico, Peru, and Colombia.

**Poverty Rate**
(Percent) 1/




Sources: SEDLAC (CEDLAS and The World Bank), INDEC, and country authorities.
1/ As of 2014 except Argentina official (2016Q2), Chile (2013), Colombia official (2015), and Uruguay official (2015).

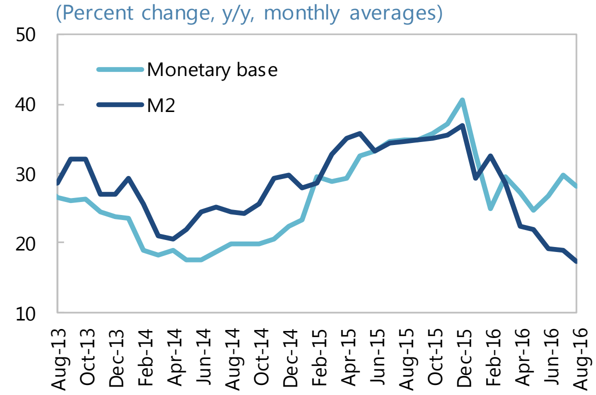
- Eliminate export taxes on most agricultural products (only for soybean and soybean products there was a reduced rate of 30 and 27 percent, respectively).

- Overhaul the national statistical agency (INDEC) leading to the publication of a new CPI and a revised series for GDP, trade, poverty, and labor market data.

- Unwind in a controlled way the significant increase in foreign currency forward contracts that were entered into by the central bank in the final months of the previous administration.

5. **These measures, while necessary to lay the foundation for robust future growth, inevitably had an adverse impact on the Argentine economy which had already began to contract in the last quarter of 2015**. The peso depreciation and increase in utility prices have pushed headline inflation (based on the City of Buenos Aires CPI) to 44 percent year-on-year (y/y) by September (core inflation of 40 percent), and household real disposable incomes have fallen, weakening consumption (Figure 1). To reassert control over inflation, the central bank quickly reduced the growth in monetary aggregates which had a contractionary impact. Public capital spending fell sharply in the first half of 2016 as the new authorities reviewed the quality of the ongoing projects with the goal of eliminating waste and corruption. Further headwinds arose from weak trading partner demand, notably Brazil, and bad weather conditions. It is important to emphasize that the measures that were taken were indispensable. While the exact form of the counterfactual is difficult to predict, failing to address the unsustainable path that the Argentine economy was on would have led to even worse outcomes that have been all-too-familiar to Argentina—potentially a run on local currency assets, spiraling inflation, an abrupt fiscal adjustment as financing sources were exhausted, and/or a depletion of foreign exchange reserves and balance of payments crisis.

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

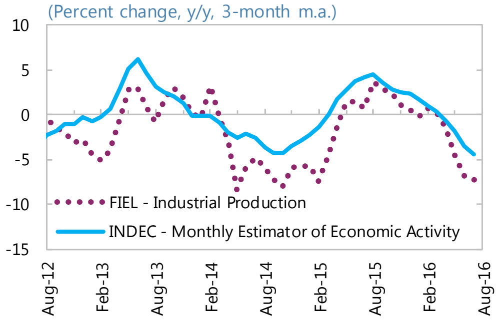



Sources: BCRA and Fund staff calculations.

## Figure 1. Argentina: Effects of the Transition

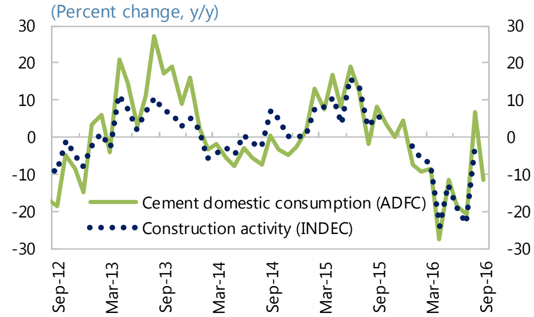
*Economic activity contracted in the first half of 2016.*

**Indicators of Economic Activity**
(Percent change, y/y, 3-month m.a.)



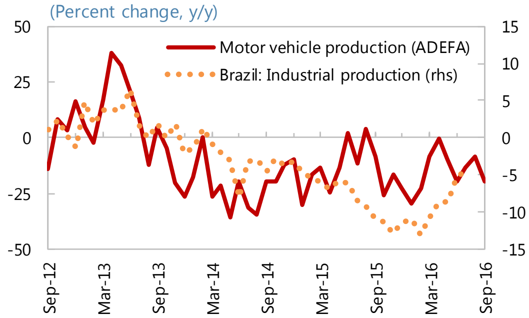

*Construction fell due to the brake on public works and unfavorable weather, but there are signs of stabilization.*

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



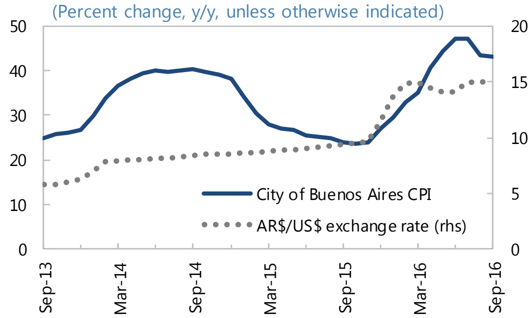

*Motor vehicle production continued contracting, hurt by a protracted recession in Brazil, Argentina's main trading partner.*

**Motor Vehicle Production**
(Percent change, y/y)



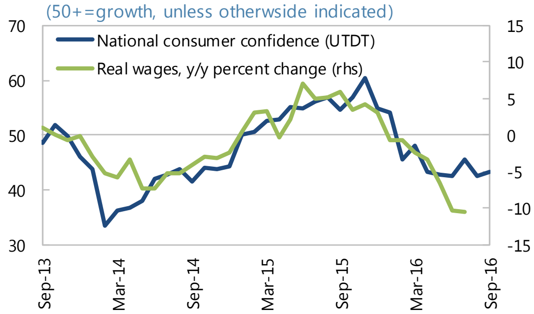

*Inflation increased as a result of peso devaluation and utility tariff adjustments.*

**Inflation and Exchange Rate**
(Percent change, y/y, unless otherwise indicated)



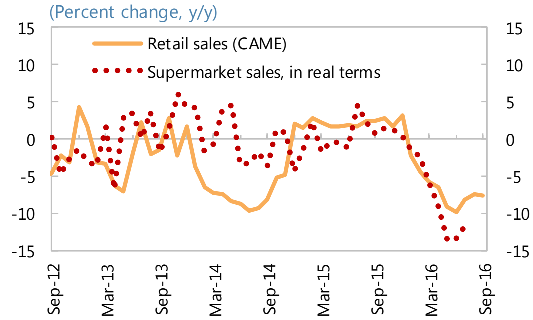

*Real wages have contracted, and consumer confidence has declined…*

**Consumer Confidence and Real Wages**
(50+=growth, unless otherwside indicated)




*…driving down private consumption.*

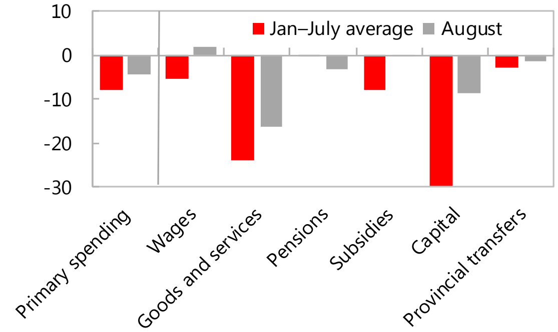
**Indicators of Consumption**
(Percent change, y/y)




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

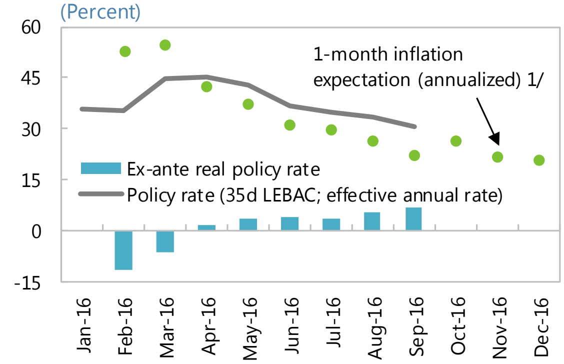
6. **The authorities responded proactively to the downturn with a moderate fiscal stimulus and a steady reduction in policy interest rates in the second half of 2016**. Federal primary spending fell by 8 percent in real terms in the first 7 months of 2016 as capital projects were scrutinized, the irregular hiring of about 10,000 public employees was reversed, and utility subsidies were reduced. This was despite an increase in pensions,[1] unemployment benefits, and child benefits in the early days of the new administration. By mid-year, efforts were being taken to support the economy through public infrastructure projects, transfers to provinces to fund public works, further increases in pension benefits (including the introduction of a universal old-age pension) and unemployment subsidies, and reducing the tax burden for small- and medium-sized enterprises (Table). To further raise fiscal resources, a tax amnesty program was announced with a 10 percent one-off tax charged on resources declared under the amnesty. Finally, the central bank lowered the policy rate (on 35-day central bank paper) from 45 to 31 percent, in effective terms, as forward-looking indicators of inflation began to fall, maintaining the ex-ante real interest rate in a range between 3 and 6 percent (with ex-post rates exhibiting strong volatility but trailing on average below ex-ante rates since early 2016). As of early October, inflation expectations for December 2017 were slightly above next year's target band (12–17 percent).

**Real Growth of Federal Primary Expenditures**
(Percent change, y/y)




Sources: Ministerio de Hacienda, INDEC, and Fund staff calculations.

**Policy Rate and Inflation Expectations**
(Percent)




Sources: BCRA, Consensus Forecast, and Fund staff calculations.
1/ Expectations: Consensus until June, BCRA's REM since July.

[1] In compliance with past rulings of the Supreme Court, the June 2016 "*Ley de Reparacion Historica*" recognized a debt to current retirees derived from the incorrect calculation of initial benefits and the improper application of the indexation mechanism starting from 2002. The law also introduced a universal old-age pension that extended pensions to all those 65 years and older without a contributory pension.

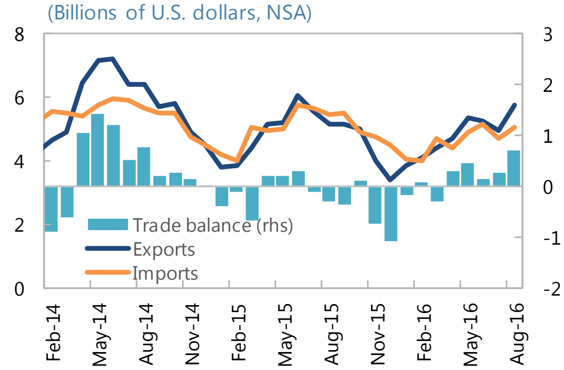
## Argentina: Fiscal Policy Measures

| Measure | Announcement date | Description | Impact (percent of GDP) | |
|---|---|---|---|---|
| | | | 2016 | 2017 |
| Export tax cut | December 2015 | Elimination of export taxes on all products except soy products and leather. Cut in soy export tax rate by 5 percentage points. | 0.6 | 0.3* |
| VAT tax cut | January 2016 | VAT tax rebate on basic staples for low income households. | 0.2 | 0.1* |
| Income tax reform | January 2016 | Increase in minimum taxable income to AR$30,000 per month. | 0.9 | 0.8* |
| Pension package | May 2016 | • Retroactive payment of AR$83 billion to litigating pensioners over 4 years, with half the amount paid in cash in H2 2016 and the remainder paid in equal portions between 2017 and 2019; to be financed below the line through the sale of FGS assets.<br>• Increase in monthly pension of ½ million litigating pensioners by 45 percent, and of 2 million non-litigating but eligible pensioners by 35 percent, amounting to a projected increase in pension flows of AR$7 billion in 2016 and AR$60 billion in 2017.<br>• Introduction of a universal pension to all seniors 65 years and older, equivalent to 80 percent of the minimum pension. | 0.1 | 0.6 |
| Increase in AUH child subsidies | January 2016 | Expansion of beneficiaries of AUH child allowance to include children of monotributistas. | 0.1 | |
| Increase in unemployment benefits | June 2016 | Increase in unemployment benefits from AR$400 per month to AR$3,000 per month for about 60,000 people. | 0.01 | |
| Subsidy for oil exports in Chubut | February 2016 | Subsidy of US$10 per barrel for oil exports, of which US$7.5 covered by the federal government and US$2.5 by Chubut, effective for 6 months, in order to induce oil companies in area to normalize drilling operations and avoid layoffs. | 0.05 | |
| Subsidy for dairy farmers | February 2016 | Payment of AR$0.40 per liter for the first 3,000 daily liters of milk produced in October-December 2015. | 0.01 | |
| Increase in coparticipation transfers to provinces | January 2016 | Repeal by Supreme Court of 15 percent tax coparticipation by provinces, earmarked to finance ANSES, and one-time increase in coparticipation transfers to City of Buenos Aires (offset by cut in federal spending on police). | 0.2 | 0.2 |
| Increase in capital expenditure | January 2016 | Increase in capital expenditure towards infrastructure projects at the federal and provincial level. | | 0.2 |
| Promotion regime for SMEs | July 2016 | Tax incentive program for SMEs, including: (i) elimination of the presumptive income tax (*ganancia minima presunta*); (ii) income tax deduction equivalent to 10 percent of new investments; and (iii) 90-day deferral for VAT payments. | | 0.1 |
| Reduction in energy subsidies and introduction of *tarifa social* | December 2015, August 2016 | In February 2016, 245 percent weighted average increase in electricity tariffs for corporate and residential users across the country, relative to September 2015. In April 2016, 166 percent weighted average increase in natural gas tariffs for corporate and residential users across the country, relative to November 2015. *Tarifa social* introduced for low-income segments of the population, in addition to 150 kWh of free electricity per month for poor households. Public transport tariffs also increased, with uncertain fiscal savings given increased fuel cost to government for service provision. In August 2016, the Supreme Court ruled for a reversal of the increase in residential natural gas tariffs, bearing a fiscal cost of about 0.2 percent of GDP in 2016. The government has since announced a 3-year plan to phase out natural gas tariffs by 2019, with the exception of the *tarifa social* that will be maintained. The estimated fiscal savings in 2017 amount to ½ percent of GDP. | 1.8 | 1.0 |
| Increase in spending efficiency | December 2015 | Increase in efficiency of government expenditure in areas deemed inefficient, including through the elimination of 11,000 improperly hired public sector employees. | 0.8 | |
| Tax amnesty | May 2016 | Tax amnesty program for undeclared funds, with varying tax levels depending on amount of funds declared, and options to invest in government bonds of varying tenors in lieu of paying tax. | | 0.3 |
| Reduction in provincial transfers | October 2016 | Reduction in discretionary tranfers to provinces, included in Budget 2017. | | 0.5 |

Sources: Ministerio de Hacienda and Fund staff estimates.
* These estimates represent the forgone revenue or savings from the measures implemented in 2016; they are not new measures.

7. **The trade balance has returned to a small surplus so far in 2016**. The devaluation and the removal of trade restrictions incentivized agricultural producers to sell previously accumulated stocks but adverse weather conditions, weak external demand (notably in Brazil), and lower commodity prices meant that exports were still about 2 percent lower in the first eight months of 2016 than in the equivalent period in 2015 (despite stronger volume growth). The cross-currents from the removal of restrictions on imports, on the one hand, and the depreciation, weak demand, and lower import prices, on the other, left import growth at relatively high levels. The resolution with holdout creditors and a rebound in dividend payments to offshore parent companies (as FX restrictions were lifted) resulted in a modest worsening in the net income account (on a cash basis).

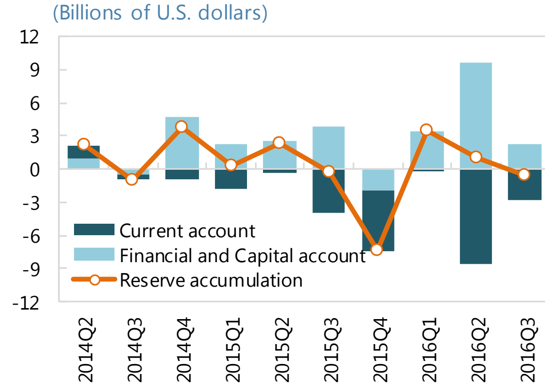
**Goods Trade**
(Billions of U.S. dollars, NSA)




Sources: INDEC and Haver Analytics.

8. **Capital inflows have maintained the peso within a narrow, market-determined range versus the U.S. dollar**. Residents took advantage of the removal of FX restrictions by moving assets abroad in 2016 but these outflows were more-than-offset by public sector external debt issuance. FDI inflows increased modestly (US$1.8 billion in the first nine months of the year, on a cash basis). With a stable nominal exchange rate, the high inflation has appreciated the real exchange rate by 10 percent since the unification of the exchange rate. The external position is judged by staff to be moderately weaker than implied by medium-term fundamentals and desirable policies (Box 2 and Annex I). The authorities have maintained their commitment to a floating exchange rate arrangement, while building reserves opportunistically, mostly through the proceeds of external debt issuances by the sovereign.

**Balance of Payments Flows**
(Billions of U.S. dollars)

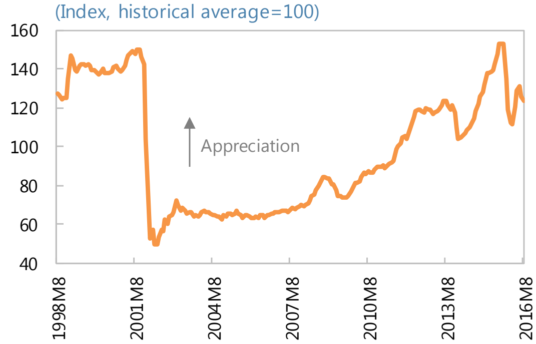



Sources: BCRA and Fund staff calculations.

## Box 2. Current Accounts and Exchange Rate

**Exchange rate and current account developments**. Tight controls on balance of payments flows and high inflation caused the real effective exchange rate (calculated using the City of Buenos Aires CPI) to become overvalued by an estimated 50 percent in November 2015. While the removal of FX restrictions in mid-December 2015 resulted in an immediate 40 percent devaluation of the peso, as of August 2016 the real effective exchange rate (REER) was about 10 percent above its early 2016 level. Despite extensive trade and FX restrictions, Argentina's current account balance deteriorated from near balance in 2012 to -2½ percent of GDP in 2015, reflecting falling commodity prices, strong domestic demand, the real appreciation of the peso, and the sharp worsening of the energy trade balance.

**Real Effective Exchange Rate**
(Index, historical average=100)




Sources: Haver Analytics, BCRA, and Fund staff estimates.

**Current account and REER assessment**. Although there is considerable uncertainty about any estimated range, the real exchange rate appears modestly above the level implied by medium-term fundamentals and desirable policies. The CA-regression approach of External Balance Assessment (EBA) yields a cyclically-adjusted CA norm of about -1 percent of GDP. The desirable fiscal stance subsumed in this estimate is based on a reduction of the overall general government fiscal deficit by about 4 percent of GDP over the medium term (consistent with the authorities' announced fiscal consolidation plans and staff's baseline). The assessment also assumes an increase in the FX reserves over the medium term to around US$70 billion. With a 2016 cyclically-adjusted CA deficit of about 2¾ percent of GDP, the current account gap is estimated to be about -1½ percent of GDP. To a considerable extent, this CA gap is explained by the fiscal and FX reserves policy gaps. The external stability (ES) approach suggests that the current account balance needed to stabilize the net IIP position to staff's estimated steady-state value is about -¾ percent of GDP (see Selected Issues Paper, Chapter 7). Using an estimated elasticity of the current account to changes in the real exchange rate of 0.13 suggests that the REER is overvalued by around 12–15 percent.

**Exchange Rate Assessment Tools**
(Percent of GDP unless otherwise indicated)

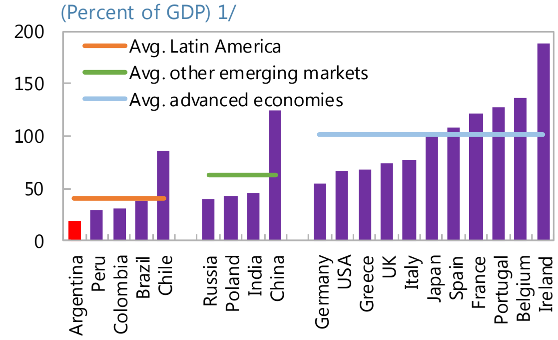
| | Level 2016 | 'Norms' | CA gap | REER gap (percent) |
|---|---|---|---|---|
| | | *ES approach* | | |
| Cyclically-adjusted CA | -2.7 | -0.8 | -2.0 | 15.0 |
| | | *EBA-lite* | | |
| Cyclically-adjusted CA | -2.7 | -1.1 | -1.6 | 12.3 |

Source: Fund staff estimates.

9. **Argentina's financial system appears resilient to the ongoing macroeconomic transition**. Argentina's financial system is mostly transactional and has generally low exposure to credit or exchange rate risk. Banks are well capitalized (total and tier 1 capital ratios are well above regulatory minimums at 16.2 and 15.3 percent, respectively, as of June 2016), have low non-performing loans (under 2 percent), and relatively large provisions (above 140 percent of nonperforming loans). The liquidity position of the banks appears comfortable, with the liquidity coverage ratio in 2016 well exceeding the minimum set by the Basel Committee. Currency

mismatches are low and banks have an aggregate net long FX position which limits risks from a sudden currency depreciation.[2] Corporate leverage is generally low since companies mostly lacked access to external funding and the domestic financial system is small. Household debt is also relatively low.

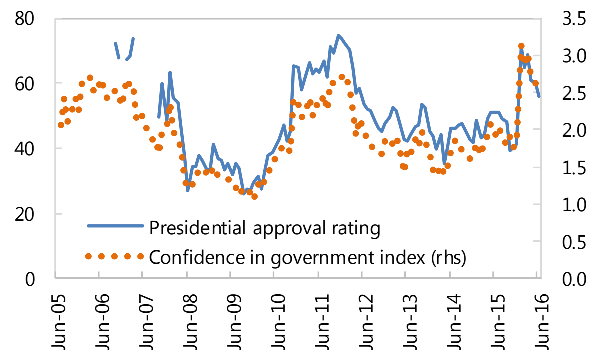
**Corporate Debt**
(Percent of GDP) 1/




Source: BCRA.
1/ Data as of 2014, except Argentina as of Dec-2015 (estimated).

10. **The administration's approval ratings remain high although the political climate is becoming more challenging**. Despite the economic recession, the government's approval rating remains above levels seen during the previous administration, and is one of the highest in Latin America. However, the government does not have a majority in Congress, and passage of legislation is likely to become increasingly complex in the run-up to the October 2017 congressional and gubernatorial elections. A weak economy and high poverty rates are likely to influence the congressional discussion of the 2017 Budget, and high inflation is likely to be at the forefront in the next round of collective wage negotiations (that is about to get underway).

**Government Approval Rating and Confidence in Government Index**




Sources: UTDT and Poliarquia.

# OUTLOOK AND RISKS

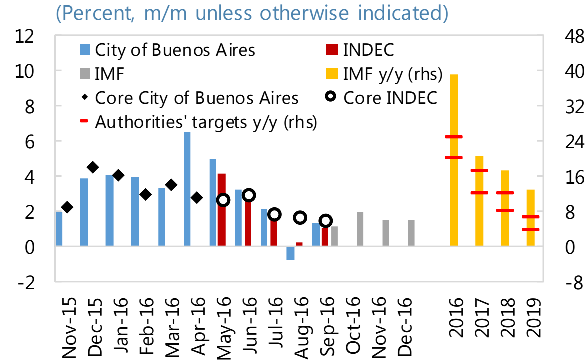
11. **The economy is expected to emerge from recession in late 2016 as the one-off impact of the initial measures to remove macroeconomic distortions begins to fade**. Staff is now forecasting growth of -1¾ percent for 2016 as a whole rising to 2¾ percent in 2017, one of the largest growth turnaround in the October 2016 *World Economic Outlook*. A modest headwind from the planned reduction of the fiscal deficit should be offset by a pickup in private consumption, an improving external environment, and a rebound of private investment. Over the medium term, growth is expected to average around 3 percent as reforms are put in place to strengthen the business environment, encourage investment, lower inflation, and restore order to fiscal finances. However, data challenges and the uncertain process of Argentina's transition away from its previously unsustainable path create significant uncertainty in the outlook.

[2] Banks' gross FX position is also low as it represents around 17.6 percent of assets and 17.7 percent of liabilities (data as of July 2016). Much of the FX assets are very liquid (deposits at the BCRA and cash), with 29.3 percent corresponding to FX loans. But banks can only grant FX loans to those who actually have FX income (mainly exporters) which significantly reduces risks from a depreciation of the peso.

12. **Inflation will continue to decline at a slow pace due to a relatively high degree of inertia in the determination of wages and prices**. Inflation has decelerated sharply since its peak in April, as the pass-through from the exchange rate depreciation and the effects of the tariff adjustment have dissipated. In August and September 2016, official headline inflation was affected by the reversal of the increase in natural gas tariffs, which subtracted about 0.7 percentage points to the index values in both months. Core inflation continued to decline and reached 1½ percent (m/m) in September, consistent with about 20 percent annual rate. However, collective wage bargaining is still likely to inject a backward-looking element into the determination of nominal wages, and this nominal inertia is expected to slow the pace at which inflation falls (Box 3). Headline inflation is forecast to fall to 20 percent by end-2017—assuming nominal wage increases can be held to around 25 percent and energy subsidies are scaled back in line with the budget assumptions—and to single digits by 2021. A faster pace of disinflation appears unadvisable given the significant impact on growth that would accompany such a path for inflation.

**Inflation**

(Percent, m/m unless otherwise indicated)

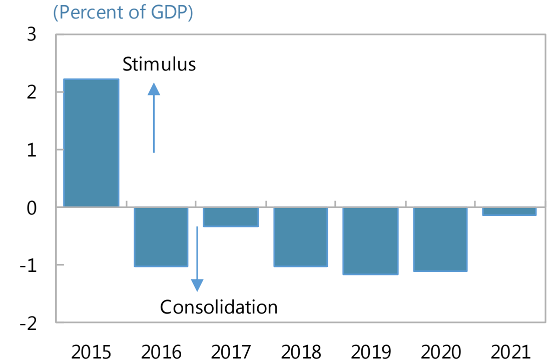



Sources: INDEC, Government of the City of Buenos Aires, and Fund staff calculations and estimates.

13. **The primary federal deficit is expected to fall to 4½ percent of GDP in 2017, a close to neutral fiscal stance in cyclically adjusted terms**. Based on the authorities' budget plans, in 2017 spending on pensions and public works is expected to be more than offset by a 1 percent of GDP reduction in transfers to the private sector (half of which reflects lower energy subsidies) and a ½ percent of GDP cut in discretionary transfers to provinces. At 4½ percent of GDP, staff's forecast of the federal primary deficit is modestly higher than the deficit in the proposed 2017 Budget (4.2 percent of GDP) due to differences in macroeconomic projections. After 2017, the primary federal deficit is expected to improve by around ¾ percent of GDP per year, a result of an elimination of energy subsidies by 2019 and lower spending on goods and services and other current spending. Gross debt of the federal government is projected to fall slowly (from 52 percent in 2015 to 48 percent of GDP by 2021), reflecting the lower deficit and the projected real appreciation of the peso. Despite this adjustment, the gross fiscal financing needs in 2017 are around 11 percent of GDP, which are expected to be met through an increase in external debt, central bank financing of

**Federal Government: Fiscal Impulse**

(Percent of GDP)

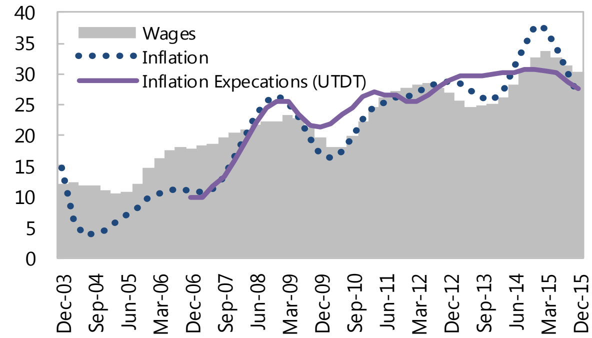



Sources: Ministerio de Hacienda and Fund staff estimates.

## Box 3. Inflation, Expectations, and Wages

**Some stylized facts**. Nominal wages grew at a much faster pace than inflation after the 2001 crisis, allowing real wages to return to pre-crisis levels by 2005. Since then, real wages have been relatively sticky despite recessions in 2009 and 2012. Persistently high inflation and inflation expectations have added to nominal inertia with a wage setting system that is characterized by extensive sectoral wage bargaining and a de-facto high level of wage indexation, despite the lack of formal backward indexation.

**Inflation and Wages**
(Percent change, y/y 4-quarter m.a.)




Sources INDEC, Haver Analytics and Fund staff calculations.

**An inflation model**. Estimating a small macroeconomic model for Argentina reveals a relatively high degree of persistence in nominal wage growth, inflation, and inflation expectations. Real wages appear to respond relatively weakly to changes in real activity:

$$\dot{p}_t = 0.51\dot{p}_t^e + 0.47\dot{w}_t - 0.37r_t + \epsilon_{\dot{p},t}$$

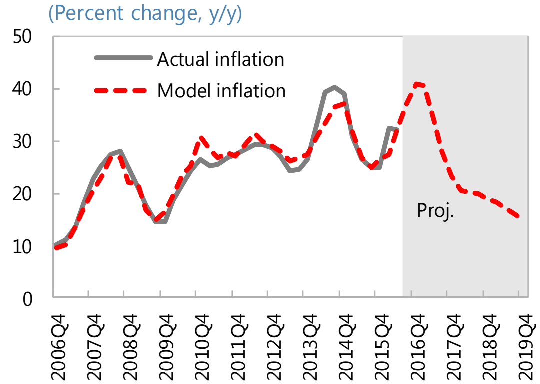
$$\dot{p}_t^e = 5.4 + 0.57\dot{p}_{t-1}^e + 0.12\dot{e}_t - 0.41r_t + \epsilon_{\dot{p}^e,t}$$

$$\dot{w}_t = 0.96\dot{w}_{t-1} + 0.13g_t + \epsilon_{\dot{w},t}$$

where $\dot{p}_t$ is inflation rate, $\dot{p}_t^e$ inflation expectations, $\dot{w}_t$ nominal wage growth, $r_t$ the real interest rate, $g_t$ GDP growth, $\dot{e}_t$ the exchange rate appreciation, and $\epsilon$ are shocks.

**Model performance and forecasts**. The estimated model seems to fit relatively well Argentina's inflation dynamics over the last decade. Simulating the model forward, shows inflation declining from 39 percent at end-2016 to 20 percent in 2017. This would be accompanied by a further 3¾ percent real appreciation of the peso and 2.7 percent growth in 2017. Using this same model, reducing inflation to 17 percent by end-2017 (the upper end of the central bank's target band) would require a 400 basis point increase in the path of real interest rates during the course of this year and next, and would result in a one percentage point lower growth in real activity in 2017 relative to staff's baseline.

**Inflation Model for Argentina**
(Percent change, y/y)




Source: Fund staff estimates.

1½ percent of GDP, and domestic debt issuance. Gross fiscal financing needs are expected to remain substantial over the medium term, averaging 8½ percent of GDP in 2018–19.

**Macroeconomic Assumptions**
(Percent change)

| | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|
| Real GDP growth | | | | | |
| Fund staff | 2.5 | -1.8 | 2.7 | 2.8 | 2.9 |
| Authorities | 2.4 | -1.5 | 3.5 | 3.5 | 3.5 |
| Total consumption | | | | | |
| Fund staff | 4.1 | -1.8 | 2.3 | 2.7 | 2.7 |
| Authorities | 5.3 | -0.9 | 3.5 | 3.6 | 3.7 |
| Investment | | | | | |
| Fund staff | 4.2 | -3.6 | 8.2 | 7.2 | 7.2 |
| Authorities | 5.5 | -3.5 | 14.4 | 9.5 | 7.6 |
| Exports | | | | | |
| Fund staff | -0.6 | 4.5 | 4.4 | 4.8 | 3.8 |
| Authorities | -0.4 | 6.9 | 7.7 | 6.0 | 5.2 |
| Imports | | | | | |
| Fund staff | 5.6 | 1.3 | 6.8 | 7.6 | 6.3 |
| Authorities | 5.5 | 10.2 | 9.8 | 8.4 | 8.5 |
| Total consumption deflator (average) | | | | | |
| Fund staff | 25.6 | 38.0 | 24.5 | 19.1 | 15.3 |
| Authorities | 24.7 | 35.2 | 19.4 | 13.9 | 8.3 |

Sources: Fund staff estimates and 2017 Budget proposal.

14. **The current account deficit is expected to rise steadily to 4¼ percent of GDP by 2021**. A steady appreciation in the real effective exchange rate, relatively flat terms of trade, and the swing to sustained growth are expected to add to the current account deficit. This is expected to be financed by higher public debt issuance, some repatriation of offshore funds in 2016–17 (to take advantage of the tax amnesty), and a rise of inward FDI. The central bank is expected to steadily accumulate international reserves from current low levels (to 100 percent of the IMF's reserve adequacy metric by mid-2018). The reserve accumulation will be largely as a result of converting the proceeds of government external debt issuance into pesos, consistent with the authorities' commitment to let the exchange rate float freely under the inflation targeting (IT) regime.

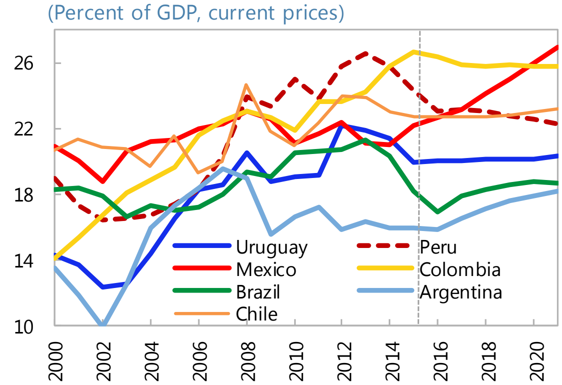
15. **The outlook is subject to a greater than usual degree of uncertainty but risks appear broadly balanced around the baseline**. Argentina is in a process of significant transition to a more market-based economic framework and is simultaneously working to rebuild the statistical information about their economy. The lack of a reliable statistical time series for certain data and the unpredictable consequences of changes in relative prices, the removal of distortions, and a reopening of the economy to international capital flows all add to the uncertainty around future economic outcomes.

16. **Upside risks**. Staff's baseline scenario is subject to a number of upside risks (Risk Assessment Matrix Table):

- *A faster rebound in private investment*. Argentine companies have relatively low levels of leverage and have neglected investing in new capacity and technologies over the past several years (in large part due to the distortions and policy interventions that the economy faced). Indeed, as of 2015, investment in Argentina is the lowest as a share of output when compared to other economies in Latin America. Under staff's baseline, the investment rate is expected to pick up gradually over time, consistent with a study of past cases of investment rebounds in advanced and emerging economies, indicating that these rebounds generally take time to build and coincide with an improvement in the fiscal position (see Chapter 1 of the Selected Issues Paper). However, with Argentina re-establishing itself in international markets and with the important efforts to remove domestic distortions already taken this year, private investment (largely financed from abroad and in both tradable sectors and domestic infrastructure) could prove to be much stronger than is assumed in the baseline. This would imply less need for fiscal support to growth and more room for maneuver to both reduce the fiscal deficit and to disinflate the economy with relatively modest output costs.

**Gross Fixed Capital Formation**

(Percent of GDP, current prices)




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

- *A more successful tax amnesty*. Increased disclosure and information sharing requirements across tax jurisdictions have the potential to create strong incentives to declare assets under the tax amnesty. This would lead to more tax revenues and, insofar as offshore funds of residents are repatriated into government bonds, would meet some of the budget financing needs.

- *A stronger than expected recovery in Brazil.* The October 2016 *World Economic Outlook* assumes Brazil's growth to rebound to 0.5 percent in 2017 after the 3.3 percent contraction in 2016. Brazil accounts for about 20 percent of overall Argentina's exports and 50 percent of its manufacturing exports, so each 1 percentage point increase in Brazil's growth above the 2017 forecast would add an estimated ¼ percentage points to Argentina's growth.

17. **Downside risks**. The gradual pace at which macroeconomic imbalances are resolved leaves Argentina vulnerable to both domestic and external shocks:

- *A tightening of external financial conditions.* Given the significant gross external borrowing needs of the government, an exogenous tightening of global capital markets could prove very disruptive. At best, a higher cost of financing would worsen debt dynamics and necessitate a stronger fiscal correction over the medium term. At worst, a sudden stop to external borrowing (e.g., owing to higher global risk aversion) could create financing shortfalls. With limited recourse to domestic financing, this could necessitate a more front-loaded fiscal adjustment at a time when external demand would also likely be weakening. Such a downside would create depreciation pressures on the currency and cause the central bank to react procyclically to contain inflation. The relatively high share of short-term foreign currency debt in a few non-financial private sector industries also poses rollover risks (see Annex I).

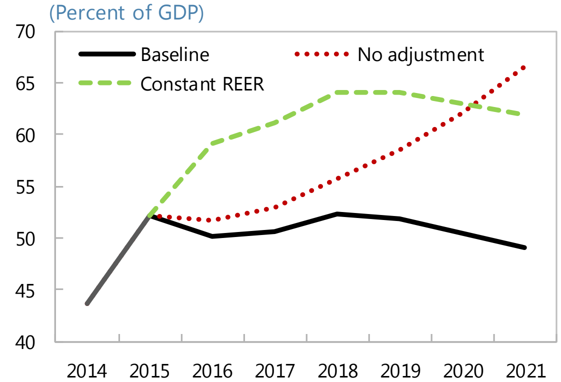
## Risk Assessment Matrix[1/]

| Source of Risks | Relative Likelihood | Expected Impact | Policy Response |
|---|---|---|---|
| **Downside Risks** | | | |
| Tighter and more volatile global financial conditions | **Medium** | **High**<br>A reassessment of global risk leads to portfolio rebalancing, lowering capital flows into risk assets, including EMs. This would limit availability of funding of Argentina's fiscal needs through external bond issuances and repatriation of funds by non-bank domestic private sector. Domestic financial sector's funding could increase, but given its small size it would not be able to meet the gross financing needs of the federal government (11 percent of GDP in 2017). | Tighter global financial conditions and limited capital inflows would require a more accelerated reduction of the fiscal deficit. |
| Higher and more persistent inflation | **Medium** | **Medium**<br>Upward pressures on inflation emerge because of higher wage growth and/or higher persistence in inflation and/or stronger second round effects from increase in tariffs. The currency could become more overvalued, and expectations of a future depreciation might increase, which would fuel inflation expectations and lower the demand for the peso. | Facing a wage-price spiral and the risk of a run on the peso, the central bank should react by increasing interest rates. A faster reduction of the fiscal deficit may also be needed to immediately reduce inflationary pressures. |
| A sudden depreciation of the currency | **Medium** | **High**<br>Continued appreciation of the currency leads to a worsening of the current peso misalignment, a deterioration of the external position, and renewed bouts of balance of payments pressures. A sharp devaluation of the currency realigns the currency and alleviates the pressures, leading to a jump in inflation and an immediate contraction of economic activity with high social costs, as household's purchasing power is reduced. High FX exposure of the public sector can lead to a spike in public sector debt and financing difficulties. | The central bank would need to increase interest rates to defend the peso, while fiscal policy could be tightened and re-oriented to protect the most vulnerable segments of society at zero cost for the budget (for example, though a faster elimination of energy subsidies, using the resources to fund means-tested transfers). |
| Significant China slowdown | **Low (in the short run)** | **Medium**<br>Weaker activity in China would impact Argentina primarily through trade channels, including through a negative impact on the terms of trade, as commodity prices would fall. This would affect especially soy sector, as about 3/4 of Argentina's soybean exports is destined to China. Staff estimates suggest that a 1 percentage point decrease in China's growth would lower Argentina's export growth by 0.4–0.7 percentage points. Slower growth in China would also affect Argentina indirectly, through its negative impact on the region, particularly on Brazil. | • The depreciation of the peso would help the economy adjust to the terms of trade shock.<br>• If needed, monetary and fiscal policy stances could be relaxed (fiscal policy could be re-oriented to protect the most vulnerable segments of society).<br>• The authorities could accelerate structural reforms to increase export competitiveness and diversification. |
| **Upside Risks** | | | |
| Stronger rebound of private investment and exports due to a more positive impact of liberalization measures | **Medium** | **High**<br>Private investment and FDI could be higher than expected reflecting stronger confidence effect. Also, export growth could be stronger reflecting more positive impact of current and capital account liberalization. A combination of stronger investment and exports could boost growth to 4½ percent in 2017, if private investment increases by at least one standard deviation of its historical average. | • The authorities could take advantage of the stronger GDP path to accelerate the pace of reduction of the fiscal deficit and to implement supply-side reforms, especially those that entail short-term costs, like elimination of subsidies and other forms of protection to specific sectors of the economy. |
| Stronger recovery in Brazil | **Medium** | **High**<br>A stronger recovery of Brazil would have important positive spillover effects on Argentina's economy. The Brazilian market is especially relevant for Argentine industrial exports. More than 45 percent of exports of industrial manufactures go to Brazil. Staff estimates suggest that a 1 percentage point increase in Brazil's growth would boost Argentina's export growth by 0.7 percentage points, and has a peak impact of ¼ percent on Argentina's growth. | • The authorities could take advantage of the stronger GDP path to accelerate the pace of reduction of the fiscal deficit and to implement supply-side reforms, especially those that entail short-term costs, like elimination of subsidies and other forms of protection to specific sectors of the economy. |
| A more successful tax amnesty | **High** | **High**<br>Based on a comparison of past experience in Argentina and abroad, it is assumed that US$30 billion of wealth is declared, generating US$1.9 billion in additional tax revenues and US$2.6 billion in budgetary financing. However, increased disclosure and information sharing requirements in foreign banks, particularly in Europe, have the potential to significantly increase the incentive to declare funds. More optimistic estimates range between US$40–100 billion. In such an upside scenario, there would be a pick up in fiscal revenues and less need for government debt issuance. The smaller crowding out of the private sector could lead to greater private investment and growth. | • The authorities could take advantage of greater fiscal revenues and stronger GDP growth to accelerate the pace of reduction of the fiscal deficit and to implement supply-side reforms, especially those that entail short-term costs, like elimination of subsidies and other forms of protection to specific sectors of the economy. |

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

- *A sudden depreciation of the currency*. The continued real appreciation of the peso under staff's baseline could make the economy vulnerable to an abrupt correction of a currency misalignment. In Argentina's own history, episodes of a persistently overvalued real exchange rate have eventually led to a sharp devaluation of the currency. Such a sudden correction could lead to a contraction of economic activity and high social costs, as the resulting jump in inflation reduces household's purchasing power. While the low FX exposure of Argentina's private sector limits the risk of severe balance sheet effects, the significant (and increasing) FX exposure of the public sector poses a risk to the public debt dynamics. For example, a 10 percent depreciation of the real exchange rate would add about 3½ percent of GDP to the public debt.

**Federal Government Gross Debt**
(Percent of GDP)




Sources: Ministerio de Hacienda and Fund staff estimates.

- *Higher and more entrenched inflation*. Higher nominal wage increases in the forthcoming collective wage negotiations and second-round effects from the increase in utilities tariffs that are scheduled to be implemented would add to inflationary pressures. This could translate into increased concerns about macroeconomic stability, including through a loss of international competiveness, and potentially trigger capital outflows and downward pressure on the currency. Monetary policy would need to react to re-establish a nominal anchor which could further eat into economic activity.

18. **Authorities' view**.

- *GDP growth* in 2017–19 is expected to accelerate more strongly than in staff's baseline. Investment and export growth are expected to rebound more rapidly than assumed by staff. The reforms taken in 2016 amount to a significant total factor productivity shock, and are expected to generate a significant rebound of economic activity, reversing the decrease of potential output and income per capita over the past decade.

- *Inflation*. Reaching the inflation target 12–17 percent at end-2017 does not look ambitious, as inflation expectations are now at levels consistent with year-over-year inflation being quite close to the central bank's (BCRA's) target next year. The authorities noted that the current monetary policy stance is adequate to lower inflation to the target range and that expectations are likely to become more forward-looking as wage and price setters increasingly understand the BCRA's strong commitment to achieve the announced inflation targets. They also noted that the increase in nominal wages needed to stabilize real wages at last year level varies across sectors. A lower cost of capital and a better economic environment make up space for real wage increases. In short, the authorities do not see a risk to their disinflation path stemming from wage negotiations.

- *Exchange rate.* The authorities are confident that the adoption of an IT monetary policy regime with freely floating exchange rate will minimize the risk of currency misalignment as experienced in the past. A strong currency should not deter the rebound of investment, given the improved business conditions, productivity enhancing measures, and the abundance of capital at a time where there is excess saving at a global level.

- *Risks.* The authorities view the risks to their outlook as mostly on the upside. Removing the pervasive distortions that were affecting trade and investment has the potential to generate an ever sharper rebound of productivity and investment, which means there is a large upside risk to their growth projections.

# RESTORING THE FOUNDATIONS FOR SUSTAINED GROWTH AND JOB CREATION

## A. Fighting Inflation

19. **Bringing inflation to a single-digit level is a key priority**. The BCRA has managed well the transition to an inflation targeting regime under difficult circumstances, and reconfirmed in September 2016 the inflation targets that were announced early in the year. The pace at which this disinflation is achieved should remain flexible and adapt to circumstances as they unfold, remaining conscious of the economic costs and, particularly, the distributional impact. For example, if inflation inertia remains high, lowering inflation to 5 percent by 2019 could result in sizable output losses (Box 4, and Chapter 4 of the Selected Issues Paper). This is why past episodes of transition from moderately high to single-digit inflation generally occurred over a longer period of time (Box 5 and Chapter 5 of the Selected Issues Paper).

20. **To support the central bank's disinflation efforts, building credibility in the monetary framework will be essential and will serve to lessen the economic and social costs in lowering inflation**. Creating robust institutional foundations for monetary policy based on inflation forecast targeting would help build credibility over time and allow price formation to gradually become more forward-looking, lessening the cost of disinflation and lowering the inflation premium that is currently built into the domestic yield curve. The announced establishment of a six-member Monetary Policy Council led by the BCRA Governor and the planned adoption (from January 2017) of the 7-day repo rate as the policy rate are positive developments.[3] Other steps that should be taken immediately to strengthen the institutional underpinnings for monetary policy include (see Selected Issues Paper, Chapter 5):

- Establishing a clear price stability mandate for the central bank with operational independence;

[3] The BCRA will conduct liquidity management and introduce standing facilities in connection with the 7-day policy rate.

- Eliminating central bank financing of the fiscal deficit;

- Moving to less frequent decision points for the policy rate as macroeconomic conditions stabilize (currently rate decisions are taken on a weekly basis); and

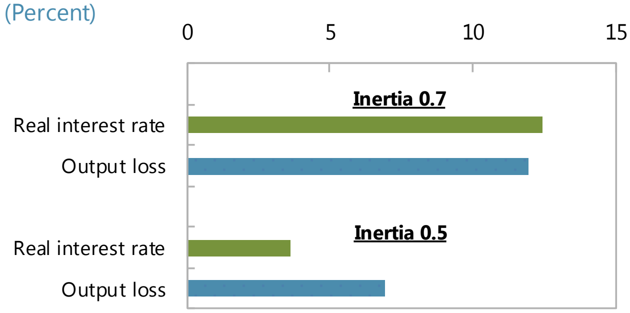
- Continuing to build credibility in Argentina's inflation statistics.

## Box 4. Inflation Inertia and the Cost of Disinflation

Reducing inflation to a single digit is an essential step to achieve a more efficient allocation of resources, increase savings, reduce income inequality, and ultimately boost the long-term growth potential of Argentina's economy. Disinflation processes, however, can also have short-term costs on economic activity, which in a large part depend on the credibility of the monetary authorities and the degree of nominal inertia in the economy, or the extent to which wages and prices are set in a forward-looking manner (Blanchard, 1998).[1] Using a small macroeconomic model estimated on Argentine data (see Selected Issues Paper, Chapter 4) allows establishing a quantitative link between the degree of nominal inertia in wage and price determination and the output cost of disinflation. With a coefficient on past inflation in the Phillips curve of 0.7, a model simulation bringing inflation from its level in Q1:2016 (33 percent, y/y, based on the City of Buenos Aires CPI) to 5 percent would require real interest rates to peak at 12 percent during the first year, resulting in a cumulative output loss over three years of slightly above 10 percent of potential GDP. However, if a greater weight was placed on forward-looking inflation, the output losses in the same model could be significantly smaller. For example, if the coefficient on lagged inflation in the Phillips curve was 0.5, this would reduce the needed increase in real interest rates by more than 6 percentage points and would halve the 3-year output costs of bringing inflation down to about 5 percent in the model simulation. These results confirm that building credibility about the inflation targets and convincing economic agents to place greater weight on forward-looking inflation in the process of wage and price determination could significantly reduce the short-term output cost of disinflation.

### Output Cost of Disinflation and Inflation Inertia[1]

(Percent)




Source: Fund staff estimates.

[1] Maximum annual real interest rate and 3-year cumulative output losses (expressed as percent of potential GDP) in a simulation where inflation is reduced from its level in Q1:2016 to 5 percent using the model described in Chapter 4 of the Selected Issue Papers. The inflation path in the two scenarios is forced to be the same.

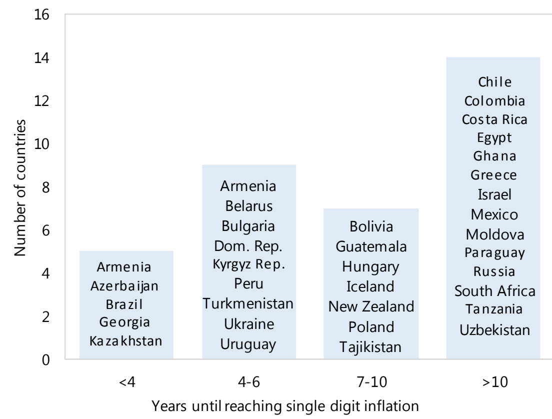
---

1/ Olivier Blanchard, "Optimal speed of disinflation: Hungary", (1998), in "*Moderate Inflation: The Experience of Transition Economies*" edited by Carlo Cottarelli and Gyorgy Szapary, IMF and National Bank of Hungary.

## Box 5. Lessons from Past Episodes of Disinflation

**Moderate inflation episodes**. A sample of 35 episodes of moderate inflation (between 10 and 40 percent, y/y) reveals that, for the bulk (30 cases) it took four years or more to reduce inflation to single rates. In almost half of these cases, it took more than 10 years to get inflation below 10 percent. In many of these cases, the persistence of moderate or high levels of inflation was accompanied by explicit indexation of contracts (which led to a backward-looking process for wage and price formation). As a result, the economic cost of lowering inflation was high, and most countries chose a more extended horizon to bring down inflation. In Latin America, for example, Chile and Colombia defeated inflation over a period of more than 10 years during the 1980s and 1990s, whereas in Mexico it lasted more than four years after the "Tequila crisis." These countries also saw a significant real appreciation of their currencies during the disinflation process (of about 50 percent in Colombia, 40 percent in Chile, and about 80 percent in Mexico).

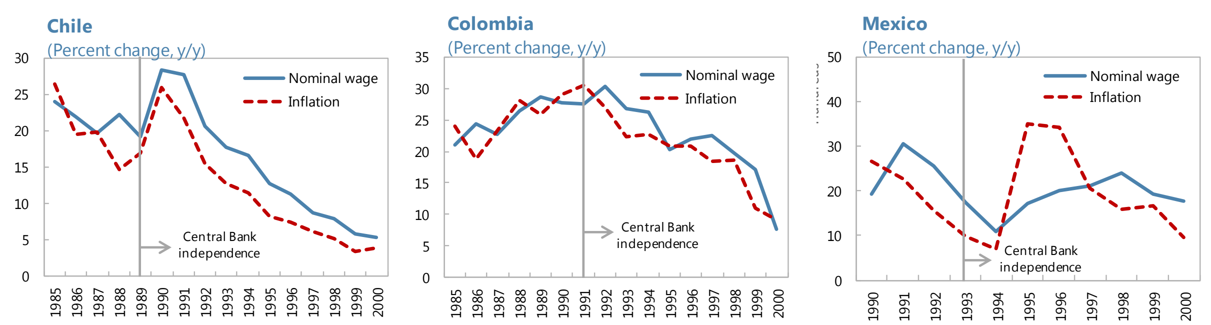
**Moderate Inflation Episodes and Convergence to Low Inflation**




Source: Fund staff estimates.

**A role for institutions**. In many of these cases, reforming the institutional framework for monetary policy was an instrumental ingredient in reducing inflation (see Cukierman and others, 2002, or Jacome and Vazquez, 2008).[1] This typically implied granting independence to central banks and assigning them a narrow price stability mandate. Fiscal adjustment also contributed to this effort. For example, Colombia, Chile, and Mexico ran a sizable primary surplus during their disinflation episodes.

**Inflation and Increase in Nominal Wages in Chile, Colombia, and Mexico, 1985–2000**




Sources: Haver analytics and Fund staff calculations.

______________

1/ See Chapter 5 of the Selected Issues Paper for the references.

21. **Authorities' view**. The authorities stated that the announced pace of disinflation is appropriate and they expect to achieve the 5 percent per year inflation target by 2019. They noted that many countries that went from moderate to low inflation more gradually over time were facing legal backward indexation (for example, Colombia in the 1990s), which is not the case of Argentina. They also noted that staff is overestimating the output costs associated with disinflation in Argentina. In the past, lower inflation in Argentina was generally associated with stronger, not weaker, economic activity. This suggests that when starting from high and distortionary inflation

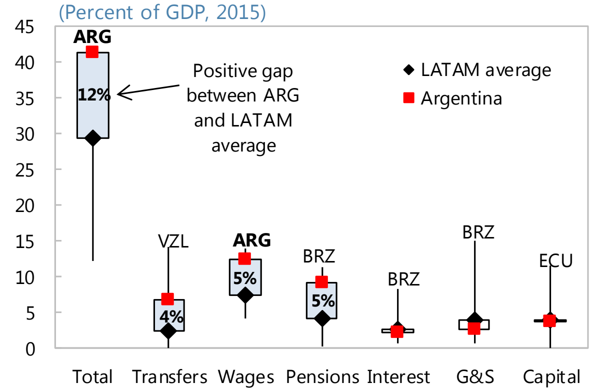
levels, reducing inflation actually increases economic activity. If expectations were to deviate from the targets announced in September, the authorities would not hesitate to tighten the monetary policy stance as needed to return to the announced disinflation path. Showing the resolution to meet the targets announced (for both inflation and transfers to the Treasury) is an effective way to build the credibility necessary to reduce inflation inertia. The authorities' position is that changing the monetary policy institutional framework along the lines suggested by staff is effective once credibility has been achieved. Their reading of the experience of other countries was of more mixed results on the role played by such institutional changes. There have been cases where the central bank's charter was changed *after* inflation had been reduced, in order to lock-in its benefits, rather than at the beginning of the disinflationary process (for example, the United Kingdom in the 1990s).

## B. Restoring Fiscal Integrity

22. **The government's plan to lower the fiscal deficit remains a vital objective**. The modest pace of fiscal consolidation for next year implied by the proposed Budget for 2017 seems appropriate given the domestic political and social constraints, and the need to support the economy at a time when the population is still digesting the implications of this year's costly transition. However, in the event the upside risks materialize, the authorities should take the opportunity to accelerate and frontload the reduction of fiscal imbalances as this would allow for a more accommodative monetary policy stance, ease the upward pressures on the currency, improve the public debt dynamics, and provide more support to the needed rebalancing from consumption towards investment. Similarly, while the pace and composition of the shift in the fiscal position after 2017 will need to remain sensitive to the impact on growth, jobs, and the most vulnerable segments of the Argentine population, frontloading the fiscal correction to the extent allowed by economic, political, and social conditions would be desirable.

23. **The needed reduction of the fiscal deficit should be based on a rationalization of government spending**. Wages, pensions, and energy subsidies have risen by 11 percent of GDP over the past 8 years. Indeed, public spending in Argentina is now the highest in Latin America and one of the highest among emerging market economies (Box 6). Much can be done to strengthen public expenditure management, improve governance, and increase the efficiency of public spending (see Chapter 2 of the Selected Issues Paper). Specifically, measures should be targeted at:

**General Government Expenditure**
(Percent of GDP, 2015)




Source: Fund staff estimates.

- *Lowering wage expenditure*. A structural reduction in public employment (at both federal and provincial levels) would be facilitated by strengthening payroll management to track and control public employees, undertaking a census to identify ghost workers, and putting in place an attrition-based reduction in government employment. In addition, decisions on nominal wage increases for public employees should be based on forward-looking prospects for inflation.

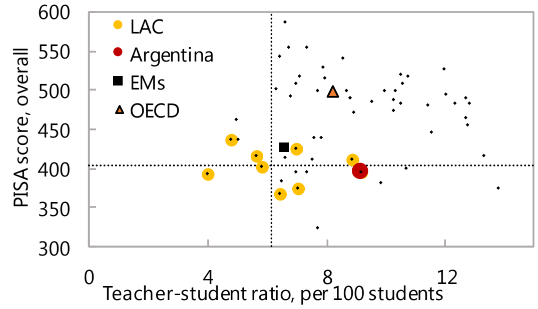
## Box 6. Government Spending in Argentina

**Wage bill**. Wages are the single largest component of general government expenditure in Argentina. At 12½ percent of GDP in 2015 (over two-thirds of which are paid by the provinces), the Argentine government's wage bill exceeded not only the regional but also the advanced economy average of 10 percent. Public employment drove the increase in the wage bill over the last decade with the number of public sector employees rising from 2.3 million to 3.9 million persons from 2001–14. Over 80 percent of this expansion was at the provincial and municipal government levels.

**Education and health spending**. About 70 percent of public expenditure in education and health is directed towards employee salaries. On education, while primary and tertiary education expenditure and indicators in Argentina are comparable to regional averages and produce relatively good outcomes, secondary school spending is high compared to peers, and does not appear to produce better education outcomes. On health, Argentina's public health expenditure amounted to 32 percent of total government expenditure, compared to 15 percent for the LA6 and OECD, and 12 percent for EMs, and efficiency frontier analysis, drawing on the outcomes of a range of other EMs and advanced economies, suggests that there may be room for efficiency gains (although health outcomes may also depend on a series of different factors, including educational attainment and access to sanitation facilities and clean water).

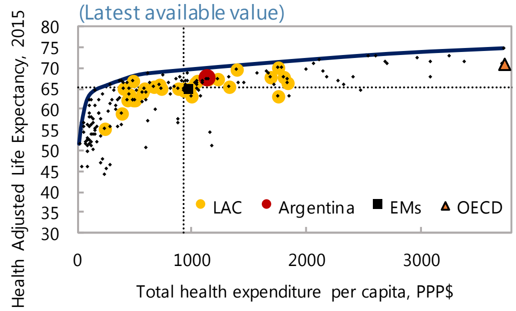
**Energy subsidies**. Energy subsidies have risen dramatically over the past decade and, at 4 percent of GDP in 2015, constitute the bulk of non-pension social transfers. These subsidies are largely regressive, with many poor segments of the population lacking access to the subsidized products (the poorest quintile of households received about 10 percent of residential natural gas subsidies and about 18 percent of residential electricity subsidies; the richest quintile received about 35 percent and 20 percent, respectively).

**Secondary School Teachers and PISA Outcomes 1/**
(Latest value available)



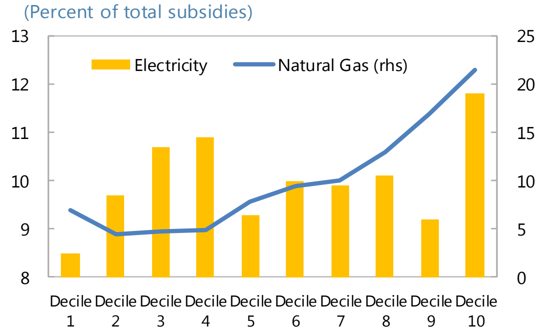

Sources: World Bank and IMF staff estimates.
1/ Dotted line is LA6 average.

**Health Spending Efficiency Frontier 1/**
(Latest available value)




Sources: World Bank and Fund staff estimates.
1/ Dotted Line is LA6 average.

**Incidence of Residential Subsidies by Income Decile**
(Percent of total subsidies)




Sources: CEDLAS (May 2015) and Fund staff estimates.

- *Eliminating untargeted energy subsidies.* The current system of regressive energy subsidies should be replaced with measures to protect the poor. This would free up significant fiscal resources to be used for more productive purposes while protecting the poorest part of the population. The government's initial efforts to raise natural gas tariffs for households were reversed by the Supreme Court. This subsequently led the government to consult with the public on a plan to bring residential natural gas tariffs back to cost recovery by 2019, with a social tariff to protect the poorest 1.5 million households. For 2017, under the proposed budget, the government plans to lower gas and electricity subsidies by about ½ percent of GDP (to about 1½ percent of GDP). Staff estimates suggest that, if successful, bringing both electricity and natural gas tariffs to cost recovery while maintaining a social tariff would reduce spending by about 1 percent of GDP.

- *Reduce pension imbalances*. Serious scrutiny of the pension system is needed to restore its financial sustainability and reduce the contingent pension liabilities that will inevitably burden Argentina's young and/or its future generations (Box 7). Spending on pensions increased rapidly over the last decade, from 4.8 percent of GDP in 2008 to 7.4 percent of GDP in 2015.[4] This was largely a product of increases in benefits (the dependency ratio during this period was broadly unchanged). The flow imbalance in the pension system will reach 2¼ percent of GDP in 2023 and over 5 percent by 2066 (see Chapter 3 of the Selected Issues Paper). The present value of the pension deficit, net of financial asset holding of the pension fund, is around 29 percent of 2016 GDP. Restoring a sustainable pension system would require parametric reforms, including indexing benefits to inflation, reducing the replacement rate, and gradually increasing the retirement age for women.

24. **Authorities' view**. The authorities stressed that gradualism and flexibility are key to a successful process of fiscal rebalancing. They noted that reducing the wage bill at both federal and provincial levels will be a slow process, largely based on attrition, given the social cost associated with reducing public sector employment in the context of a still ailing economy. The review of public sector employment done at the federal level early this year suggests there is ample room for efficiency gains. Efforts to modernize Argentina's public administration are expected to achieve significant cost savings and better quality of services over time, including by (i) integrating the administration of human resources and purchases of goods and services across Ministries and public agencies; (ii) digitalizing a vast number of administrative procedures; and (iii) reorganizing and improving the utilization of information technology at all levels of the public administration, including provinces and municipalities. On pensions, the authorities recognized that the current system faces important long-term challenges, and noted that they are beginning to study the impact of parametric reforms of the type suggested by staff. The government's analysis will be a contribution to the recently established commission on the pension reform, that will articulate a comprehensive reform of Argentina's pension system by end-2019. They noted that the effective

[4] The latter figure excludes pensions of the police and military forces (0.5 percent of GDP in 2015) and disability and other non-contributory pensions under the Ministry of Social Development (1.2 percent of GDP in 2015).

women retirement age is 63, which reduces the potential savings from increasing the minimum retirement age to 65.

### Box 7. Argentina's Pension System: Options for Reform

**Background**. Pension spending has risen due to the expansion of the number of beneficiaries and the introduction of a basic noncontributory pension. The structure of benefits has, however, been steadily flattened over time. In addition to social security contributions, the system was funded by diverting to the social security fund (ANSES) 15 percent of the national tax revenue pool. The system is partially funded with around 10 percent in GDP in assets held by the *Fondo de Garantia y Sustenibilidad*.

**Long-term projections**. The imbalances in the system are exacerbated by:

- the retroactive adjustment of benefits to past inflation introduced by the *Ley de Reparacion Historica* (which will increase pension spending by an annual 0.7 percent of GDP over the medium term);
- the introduction of a universal, minimum pension for the elderly regardless of their contribution history (adding 2 percent of GDP to spending in the long run);
- the Supreme Court ruling that the withholding of 15 percent of the common pool of tax revenues from provinces was unconstitutional (implying a revenue loss of 1.6 percent of GDP by 2020); and
- population aging (the old-age dependency ratio will double by 2066).

The cumulative impact of the net present value of pension liabilities over the next fifty years implies an actuarial deficit of the system of around 30 percent of 2016 GDP.[1]

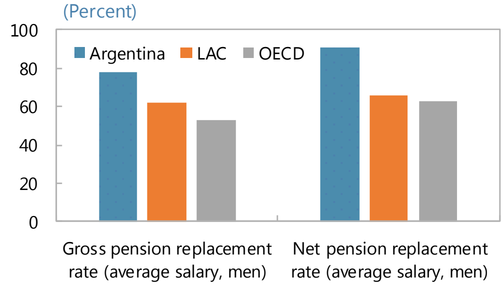
**Options for reform**. Correcting this imbalance would require some combination of:

- *Change in the indexation formula*. Pension benefits are linked to wage growth and the growth of ANSES revenues per disbursed benefit. This formula causes benefits to increase at rates above CPI inflation, and to rise faster when the growth in the number of beneficiaries slows. Indexing benefits to realized inflation from 2019 onwards would reduce the actuarial deficit by about 20 percentage points of GDP.

- *Lowering the replacement rate*. The replacement rate (the ratio of the benefit to the last wage earned) is about 72 percent of the average wage, well above the OECD average (of 53 percent). Lowering the rate to 60 percent would reduce the actuarial deficit by about 10 percentage points of GDP.

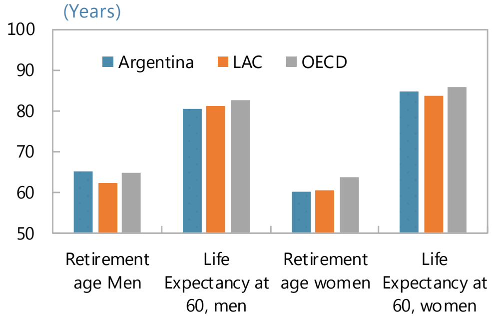
- *A gradual increase of retirement age for women*. An increase in the female retirement age from 60 to 65 over the next ten years would reduce the actuarial deficit by 10 percentage points of GDP.

**Pension Replacement Rate for a Male Earning the Average Wage**
(Percent)




Sources: OECD "Pensions at a Glance, 2015" and OECD, IADB, and World Bank "Pensions at a Glance: Latin America and the Caribbean".

**Retirement Age and Life Expectancy**
(Years)

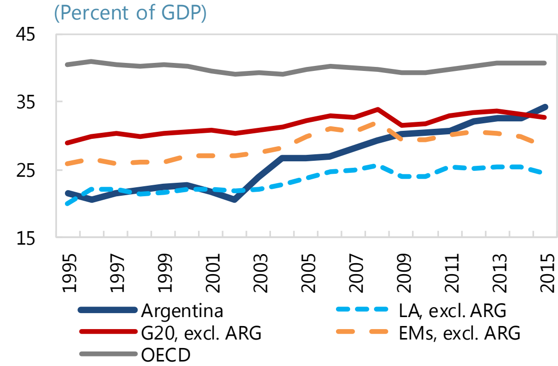



Sources: OECD "Pensions at a Glance, 2015" and OECD, IADB, and World Bank "Pensions at a Glance: Latin America and the Caribbean".

1/ The actuarial deficit is defined as the present value of the increase in the difference between benefits and contributions relative to 2015. The estimate assumes a discount rate (real interest rate–growth differential) of 2.5 percent over the long run. Using a discount rate of 1 percent would yield an actuarial deficit of 45 percent of 2016 GDP (see Selected Issues Paper).

25. **Fiscal space will also be needed to overhaul Argentina's inefficient and burdensome tax system, to make it more progressive, and to help encourage private entrepreneurship and investment**. Argentina's general government revenue as share of GDP (at 34 percent of GDP in 2015) is one of the highest in Latin America and among emerging market economies. The federal authorities have implemented a number of measures that reduced the tax burden in 2016 by about 1½ percent of GDP relative to 2015, including an increase in the threshold for income that is exempt from the personal income tax, a reduction or elimination of exports taxes, a reduction of the VAT on basic goods for low-income households, and a range of measures to reduce the tax burden on SMEs. The most immediate priorities in tax policy are to:

**Total General Government Revenue**
(Percent of GDP)




Sources: Ministerio de Hacienda, OECD, IMF WEO database, and Fund staff calculations.

- *Simplify the overall system*. There are over 35 different types of taxes collected, with 15 of them contributing only 1 percent of GDP to overall tax revenues. This imposes significant compliance costs. At the same time, indirect taxes have multiple rates and special earmarking regimes, there is a complex system of cross-exemptions and crediting that vary across the type of activity, the location of that activity, or the type of tax base.

- *Reduce the marginal tax rate on labor*. Employee's and employer's contributions for health and social security together account for between 40 and 45 percent of wages, although with a cap on employees' contributions.[5] This is above the OECD average, and hampers job creation in the formal economy. A broad-based cut in contribution rates (of 2 percentage points) could be financed by eliminating the current system of exemptions and deductions across provinces (that account for 0.3 percent of GDP).

- *Raise and preserve over time the progressivity of the personal income tax (PIT)*. High inflation and lack of adjustment of income tax brackets over the past decade meant that the PIT has become less and less progressive. The authorities are about to submit to Congress a legislative proposal that increases the dispersion of income tax brackets and marginal rates (lowering the bottom rates while increasing the top marginal rate from 35 percent to 40 or 45 percent) with an estimated annual fiscal cost of around ¼ percent of GDP (half of which borne by provinces). However, increasing the highest marginal PIT rate above the corporate tax rate (currently 35 percent) could create incentives for tax arbitrage. Going forward, it will be important to ensure that the real value of tax brackets is preserved.

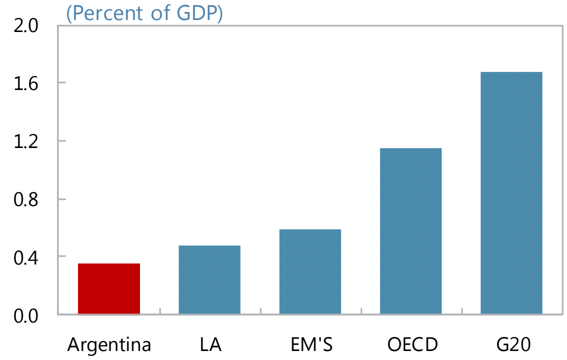
[5] The tax base for employee's social security contribution is capped at an amount that is revised twice yearly according to the pension indexation formula. Currently, the cap is 56,058 pesos per month, which is a little above double the average wage of those contributing to the social security system.

- *Reduce the marginal tax rate on new capital.* At 35 percent, the corporate income tax (CIT) statutory rate is one of the highest in the region, and the lack of provisions to adjust depreciation and capital allowances for inflation further increases the marginal tax rate on new capital formation. There are also limited provisions for carrying forward losses, limited allowances for depreciation, and low tax credits for R&D spending that raise the effective burden on incremental investments. To encourage new physical and intellectual capital formation, the CIT rate should be lowered by 5 percentage points, incentives for new R&D spending should be expanded, and new investment should be encouraged through more generous depreciation allowances, longer loss carry-forward, and inflation indexation of costs. The estimated annual cost of these measures would be 0.3 percent of GDP for provinces and 0.2 percent of GDP for the federal government.

- *Phasing out the financial transaction tax.* The high marginal rate levied on transactions in checking and saving accounts distorts the payment systems, discourages financial intermediation, and incentivizes payments in cash. Removing this tax would imply a loss for the federal government of about 1 percent of GDP.

- *Replacing the gross turnover tax and increasing property taxes.* Provinces should raise the property tax (which yields about 0.3 percent of GDP, well below international and regional levels)[6] and replace the gross turnover tax—a multi-stage sales tax that creates distortions through cascading—with a less distortionary tax on goods and services (the rate and base of which would need to be determined by provinces so that the impact on is revenue neutral).

**Property Tax**
(Percent of GDP)




Sources: Ministerio de Hacienda, OECD, IMF WEO database, and Fund staff calculations.

The net effect of all these measures is estimated to imply a loss of revenues of around 1¼ percent of GDP for the federal government (and a further ¾ percent of GDP for the provinces). To minimize the impact on the budget and to support a pickup in private investment, a simplification of the tax system and changes in the PIT and CIT could be implemented first, along with the reduction in social security contribution rates, while the elimination of the financial transaction tax could be phased in gradually. Changes at the provincial level need to be coordinated with the reforms of the national tax system.

26. **Authorities' view**. Reducing the high tax burden is essential, but any substantial changes in Argentina's tax system will need to be phased in gradually, to make sure that the fiscal costs are sustainable. The authorities noted that, together with this year's increase in the minimum income subject to PIT (which is now one of the highest in the region), the reform proposal that will soon be

---

[6] Revenues from property taxes amount to 0.5 percent of GDP in Brazil, 0.6 in Chile, 0.7 in Colombia, and 0.7 in Uruguay.

discussed in Congress will significantly improve the progressivity of the PIT system. The proposal may include a gradual increase of the income tax brackets over the next three years, to preserve progressivity, which the authorities prefer to a formal indexation scheme as this could increase inertia and may not increase the progressivity of the tax during the disinflation process. The financial tax is a distortionary tax that weighs especially on SMEs, but can be eliminated only with caution and within a more general reform of the tax system, given the large amount of revenues that it raises. There is also a general agreement that the gross turnover tax is highly distortive, but replacing it with another tax (such as a VAT or a sales tax at provincial level) could be too costly. These and other tax changes will be reviewed by a special parliamentary commission that will form a proposal for a comprehensive reform of the Argentina's tax system to be sent to Congress by early 2018. The authorities also expect significant increase in revenues from the ongoing reorganization of the tax administration. In particular, the objective is to reduce VAT tax evasion from the current 30 percent to the 20 percent that had been experienced a decade ago.

## C. Rebuilding Fiscal Institutions

27. **Introducing a simple, transparent, and credible medium-term fiscal plan that guides expectations would be valuable**. Such a fiscal framework should aim to improve the overall management of fiscal policy, strengthen the credibility of fiscal objectives, and improve the identification and management of fiscal risks. Some elements of a fiscal framework are already formally in place in Argentina, under the existing Fiscal Responsibility Law (FRL), but the system lacks credible enforcement.[7] A complete revamping of the existing legislation could take time. However, pending a fuller reform, both federal and provincial governments could introduce simple and transparent medium-term fiscal objectives (for example, on fiscal deficits) in a clear and concise policy statement that would be presented alongside the annual budget. That statement would include details on the macroeconomic assumptions underlying the medium-term budget and the key policy measures to be taken to achieve the deficit objectives. Over time, as uncertainty subsides and credibility increases, other measures could be adopted to strengthen the fiscal framework including:

- *Introducing a medium-term debt target, limits on growth of spending, and/or an overall deficit ceiling,* with transparent and easy-to-monitor escape clauses that allow deviating from the limits in exceptional circumstances. The new framework would restrict the ability for the Executive to exceed budget expenditure ceilings or reallocate spending beyond certain limits without the approval of Congress. It should also include credible enforcement mechanisms, including a

[7] The Law, introduced in 2004, was suspended in 2010. It states that primary spending growth in federal and provincial budgets cannot exceed the projected rate of nominal GDP growth. It also imposes limits on debt service ratios at provincial level, and it requires the federal and provincial governments to maintain primary current balances. However, enforcement mechanisms are weak: the only sanction for the federal government is the exclusion from the Federal Fiscal Responsibility Council, a committee representing the federal government and provinces that verifies the application of the law and should coordinate fiscal policy across federal and provincial governments. Sanctions for provinces mainly include suspension from the authorization to issue debt and reductions of discretionary transfers from the federal government.

"comply-or-explain" obligation for the federal government and automatic cuts to transfers for provinces in case the limits are exceeded.

- *Develop a fiscal risk analysis framework* including the publication of a fiscal scenario analysis and long-term fiscal sustainability analysis.
- *Create a new mid-year fiscal report* with updated estimates of fiscal outturns for the year and revised medium-term macroeconomic and fiscal projections.
- *Establish a fiscal council*, with legal and operational independence, that evaluates macroeconomic and budgetary forecasts, costs new policy initiatives, assesses fiscal plans, and monitors fiscal performances (including compliance with the FRL).

28. **Authorities' view**. The federal authorities agreed that it would be important to introduce a medium-term fiscal framework, and said that they are planning to announce medium-term fiscal targets before the end of the year. They pointed to a number of legislative initiatives that should strengthen the institutional fiscal framework. In the context of the discussion of the 2017 Budget, a proposal will be examined that limits the Executive's power to increase total spending above Budget appropriations and to move spending across different items (*Ley de superpoderes*). A proposal is being considered that introduces a Congress Budget Office which would help Congress assess the fiscal impact of legislative proposals. Finally, discussions with provinces are ongoing to reinstate the Fiscal Responsibility Law over the next few months. While the exact contours of the Law are still to be determined, it would likely include caps on current spending growth and fiscal deficit targets. While the enforcement mechanisms are the same as under the old Law (and so based on the federal government's power to deny new debt issuance to provinces not complying with the limits) the authorities are confident that the greater commitment to fiscal discipline from the federal government will be shared by provinces and lend credibility to the new framework.

29. **With about 40 percent of general government spending taking place at the sub-national level, greater efficiency in government spending will require a rethink of Argentina's fiscal federal structure that**:

- *Realigns spending authority and revenue autonomy*. Provinces are responsible for a substantial share of spending but enjoy limited tax autonomy and have been depending on the federal government for financing. In 2015, one-third of total provincial resources came from by discretionary federal transfers, and around 35 percent of provincial debt is owed to the federal government. Realigning responsibilities could require returning some spending responsibility to the federal government and/or allocating more revenue sources back to the provinces.
- *Addresses the complicated and inefficient sharing of resources across provinces*. With the legislation behind the co-participation scheme unchanged since 1988, intricate layers of patches have been introduced over the years to correct for increasing socio-economic disparities across provinces and to respond to political pressures. The lack of a mechanism to adjust the distribution of revenues across provinces to reflect their changing revenue capacity and

spending needs adds uncertainty and volatility to fiscal policy at both provincial and federal levels. As such, the current horizontal distribution of shared revenue and federal transfers across provinces should be re-examined to make it more equitable, transparent, rules-based, and stable.

- *Restricts the borrowing power of provinces*. Although provinces appear to have low debt and deficits, these aggregates mask significant heterogeneity and imbalances across provinces (see Public Debt Sustainability Analysis). Debt and deficits are concentrated in a few provinces, and the large share of foreign currency denominated debt poses risks (see Annex I). Consideration should be given to strengthening prudential control mechanisms over provincial borrowing, within constitutional limitations, perhaps to allow for a more active review role for the federal government or to net debt service obligations from transfers to those provinces with weak fiscal positions.

30. **Authorities' view**. The authorities agreed that a new legal framework would be needed to strengthen the institutions and rules of fiscal federalism in Argentina. However, delivering fundamental legislative changes in this area will not be easy, as it would require a qualified majority in Congress and approval from all provinces. The gradual devolution to provinces of the 15 percent of co-participation revenues once attributed to ANSES is expected to alleviate the financial difficulties experienced by many provinces last year. Therefore, provinces are expected to reduce their external borrowing going forward. If this were not to happen, the federal authorities are ready to tighten their debt approval policy, or to link it more explicitly to the issuance of debt needed to finance an increase in capital spending. As envisaged in the 2017 Budget, the federal authorities are planning to reduce discretionary transfers to provinces in the future, partly offsetting the increase in co-participated revenues (the proportion of national revenues shared with provinces will increase from 37 percent in 2015 to 40 percent next year).

## D. Protecting the Poor

31. **Measures need to be taken to protect the most vulnerable from the costs of the ongoing transition**. The new poverty data released by INDEC in September describes a critical social condition (see Box 1). The current administration took measures to mitigate the effects of the ongoing transition through an expansion of social programs, an adjustment in pensions, lower VAT on basic goods, increasing the minimum income subject to PIT, and the introduction of a social tariff for electricity and natural gas. Going forward, eliminating the highly regressive energy subsidies and introducing a comprehensive mean-tested transfer program will help provide well-targeted support to the poorest households. While such a safety net is being designed and implemented, the government should maintain a lower tariff structure for low-income consumers. A lower tax on labor would incentivize formal employment and bring more people under the umbrella of existing social programs (including the public health and the public pension scheme).

32. **But fundamentally it will be stronger and sustained growth and lower inflation that will help reduce poverty**. Sustaining job creation by removing macroeconomic imbalances and securing strong and durable growth will have an important impact on supporting the poor. Using

CEDLAS estimate of the poverty level and staff estimate of the elasticity between GDP growth and poverty, suggests that a one percent increase in per capita GDP per year would reduce poverty rate by 0.4 percentage points.[8] This implies that, under the staff baseline, the poverty rate would decline by about 3¼ percentage points by 2021. A significant reduction of inflation will also help the protect living standards of low income households. Continued progress in fostering gender equality in the economy and addressing the remaining gender gaps would also contribute to increasing Argentina's potential growth and economic welfare (Box 8). This could require well targeted gender budgeting initiatives, in particular with a focus on programs that facilitate or promote access of women to educational and preventative health services (IMF, 2016).[9]

33. **Authorities' view**. The authorities emphasized that protecting the most vulnerable from the potential negative impact of the reforms is a key policy objective, and voiced a strong commitment to reduce the poverty rate. In addition to the tax and spending measures taken by the administration during the course of 2016, the authorities noted that their social policy will be based on three main areas: (i) adopting an income policy that prevents excessive labor conflicts and fosters consensus, (ii) improving the quality of public goods (including health and education), and (iii) promoting inclusiveness and social mobility through more efficient and targeted social transfers, which are better linked to active labor market policies. With between 1 and 1.5 million workers receiving less than half of the minimum wage and largely in the informal sector, measures that build job-related skills are needed to help reintroduce this segment of the labor force into Argentina's formal economy, although only strong growth will produce quality and sustainable employment. The authorities also agreed that disinflation will reduce the inequality of the income distribution, given the disproportionate incidence of the inflation tax on low-income households. In particular, they noted that the inflation tax represents 20 percent of the income of the lowest decile of Argentina's households but only 3 percent for the top decile.

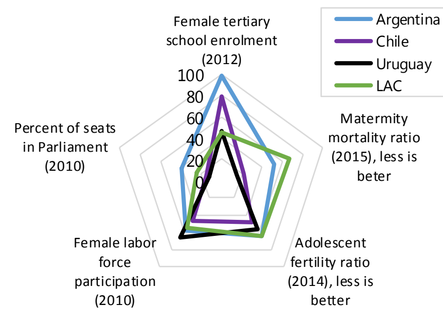
[8] The growth elasticity of poverty is estimated as the percent change in poverty with respect to a one percent change in per capita GDP, using CEDLAS data for poverty and INDEC GDP data for the period 2004–14.

[9] Lucía Pérez Fragoso and Corina Rodríguez Enríquez, "*Western Hemisphere: A Survey of Gender Budgeting Efforts*" (2016), IMF Working Paper n. 153.

## Box 8. Gender Gap Issues in Argentina

Argentina's levels of female education and political representation exceed those observed in the region. Argentina stands out in terms of female school enrollment, vis-à-vis Chile and Uruguay, and even more when compared to the average level of female education in Latin America and the Caribbean (LAC). Argentina is a leader in the region in female political representation and fares well in terms of women's labor force participation. However, when it comes to indicators of maternity mortality and adolescent fertility, Argentina is lagging behind its neighboring countries.

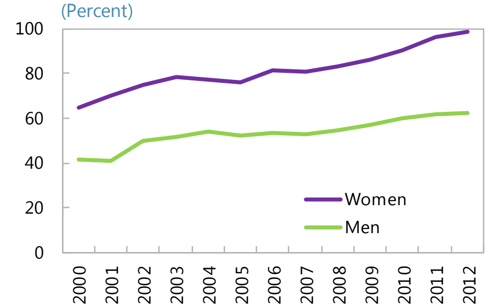
**Selected Gender Indicators**




Sources: World Bank Equity Lab, Gender Note (2012), and Fund staff calculations.

- Between 2000 and 2012, female gross tertiary school enrollment increased from 64.7 percent in 2000 to 98.5 percent, surpassing men enrollment by a ratio close to 1.6. Higher education has allowed women to increase their labor participation rate from 43 to 48 percent between 2000 and 2014 and to reduce their unemployment rate from 17 to 10 percent—measured as a proportion of female labor force—over the same period. Nevertheless, in 2010, women's average earnings were only 77 percent of men's. Moreover, in a sample of firms with a total of 21,000 employees, women accounted for only 37 percent of managers and directors (World Bank 2012). Female participation in politics is high, as they held 38 percent of seats in parliament, both at the national and subnational levels, in 2010, up from an average of 9 percent between 1990 to 2010, as a result a system of quotas established by the Electoral Law.

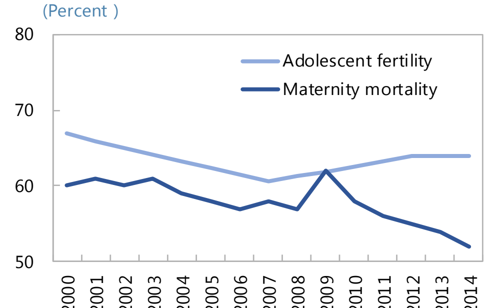
**Tertiary School Enrolment**
(Percent)




Sources: World Bank Equity Lab and Fund staff calculations.

- Female health conditions have improved, but some recent reversals in teen births and levels of domestic violence are worrisome. Health indicators, such as birth attendance by skilled health staff and the number of pregnant women receiving prenatal care show that coverage is close to universal. The maternal mortality ratio—measured by 100,000 live births—declined from 60 percent to 52 percent between 2000 and 2015. However, the adolescent fertility rate—computed as the number of births per 1,000 women ages 15 to 19—has increased by about 4 percentage points since 2007 (while overall fertility has decreased). Women's health is also impacted by the prevalence of domestic violence in one out of five couples as of 2008.

**Adolescent Fertility and Maternity Mortality**
(Percent )

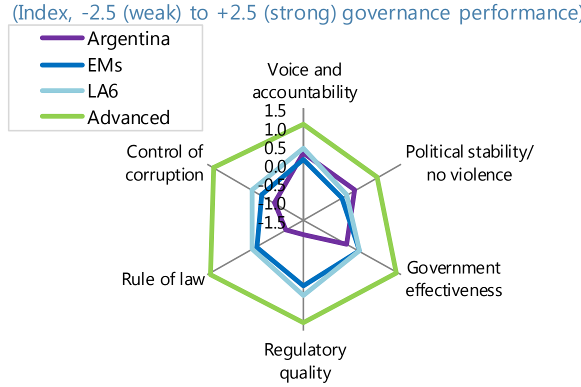



Sources: World Bank Equity Lab, and Fund staff calculations.

## E. Creating New Institutional Structures

Worldwide Governance Indicators, 2014

(Index, -2.5 (weak) to +2.5 (strong) governance performance)




Source: World Bank WGI, 2015 Update.

34. **Improving governance, increasing transparency, and tackling corruption are key priorities**. Strengthening public institutions and clearly articulating their roles and responsibilities will be essential to rebuild private sector confidence in public administration and support investment and growth. Over the past 15 years, Argentina saw the largest decline in ranking of any country in regulatory quality according to the World Bank's global governance indicators. Argentina also scores poorly in the areas of rule of law, anti-corruption, and government effectiveness. Despite relatively good anti-corruption regulation, enforcement has been uneven and corruption remains pervasive in public institutions, including in public procurement and public works.[10] High levels of corruption are also seen by firms as an obstacle to investing in Argentina (World Bank *Enterprise Survey*, 2015). Moreover, Argentina ranks 121 among 189 countries in terms of ease of doing business, mostly reflecting corruption and excessive bureaucracy.

35. **The authorities began taking steps to rebuild public institutions, strengthen anti-corruption controls, and step-up enforcement**. These include initiatives to promote open government, reduce bureaucracy, build human and institutional capacity, and increase digital innovation in the public sector. A new framework for public tenders of infrastructure projects has also been announced to increase transparency and prevent collusive practices. Staff welcomes the recently proposed legislative reforms to provide additional tools to prosecute corruption, seize assets linked to corruption, and introduce criminal liability for legal persons. These efforts would be complemented by effectively mobilizing the anti-money laundering (AML) framework. In particular, the authorities are encouraged to strengthen the AML/CFT controls in the financial sector, notably relating to politically exposed persons, and ensure that financial intelligence is appropriately used in advancing and supporting investigations and prosecutions of corruption.

36. **Financial deepening will create scope for domestic financing of productive activity, strengthen the monetary transmission channel, and include a greater share of the population in the financial system**. Argentina has a relatively small financial system: bank credit to the private sector is only 13 percent of GDP, and stock market capitalization is only 10 percent of GDP. To a large extent, restoring macroeconomic stability is the best contribution that policymakers can offer to the developing of local financial markets. Low inflation and positive real rates are needed to increase the base of long-term domestic currency savings that will allow banks to increase lending

[10] A government report ("*El estado del estado: Diagnóstico de la Administración Pública Nacional en diciembre de 2015*") paints a dire picture of the state of public administration and is expected to be followed by wide-ranging investigations by the Anti-Corruption Office.

to the private sector. In the meantime, some steps have been taken to encourage greater domestic intermediation:

**Financial Development**
(Percent of GDP, 2014)


Source: Global Financial Development Database.

- *Banking sector.* The BCRA has eliminated minimum interest rates for time deposits and maximum interest rates for consumer loans, increased information on bank fees, simplified procedures for opening bank accounts, eliminated bank transfer fees and fees to maintain saving accounts. In addition, the central bank has introduced a new inflation-indexed account unit, to create a market for inflation-indexed fixed income instruments (both on the deposit side and, for example, in mortgage loans).

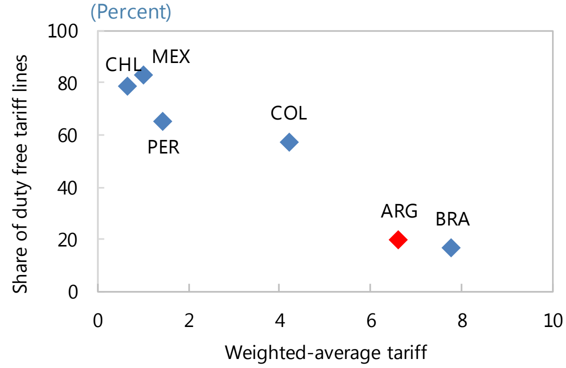
- *Capital markets*. The authorities are working at a reform of the 2012 Capital Markets Law, which aims at developing closed-end mutual funds by equalizing tax treatment with open-end funds; introduce legislation that provides for the enforceability of derivative netting; increases capital requirements for broker dealers; and improves many aspect of corporate governance, including by removing the power of the securities regulator to interfere in decisions approved by the board of listed companies and strengthening its enforcement powers to take on anti-market behavior. Progress has been made in improving capital market infrastructure: the creation of a unified stock exchange (B&MA) will increase liquidity and lower transaction costs by consolidating the trading platform, the central counterparty clearing house and the custodian agency. The new central counterparty clearing house is expected to facilitate the development of an interest rate swap market, currently quite limited in Argentina.

- *Insurance sector*. Restrictions on insurance companies (that compelled them to invest in infrastructure projects approved by a political committee and limited foreign investment) were removed. Consideration is given to introducing tax incentives for investment in long-term assets, such as life insurance and annuity products by updating the income tax deduction limits that have been frozen since the early 1990s.

- *Public pension reserve fund*. The new administration at ANSES has begun reforming the governance and investment strategy of the public pension fund, which was significantly mismanaged in the past. The objective is to preserve the fund's capital, investing in projects (mainly infrastructure projects and financial instruments that promote growth and support the development of local capital markets) and using the returns to pay for the increase in pension payments following the 2016 reforms. The authorities are considering utilizing part of the endowment to set up a trust, which would securitize mortgages originated in banks (while asking them to maintain a significant credit exposure) in order to help develop a local mortgage market.

37. **There is significant scope to lower trade barriers**. Non-automatic import licenses remain for around 1,500 tariff lines (about 10–15 percent of volumes), and there is a broad system of controls on professional services, patents, royalties, and technology transfer contracts. As part of the MERCOSUR trade bloc, in recent years Argentina has lagged behind other regional peers in trade liberalization, such as the members of the Pacific Alliance (Chile, Mexico, Colombia, and Peru).[11] A comprehensive effort should be undertaken to scale back existing trade barriers so as to raise competitiveness, encourage new investment, and increase productivity.

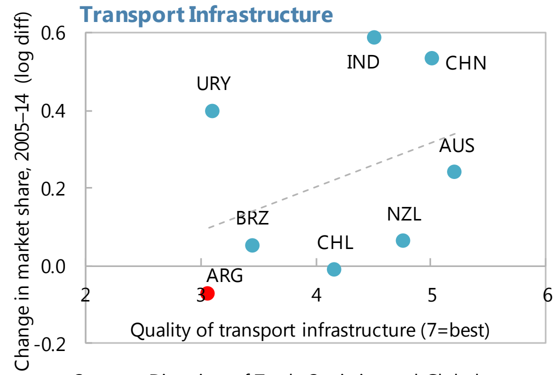
**Import Tariff Protection**
(Percent)




Sources: World Bank WITS and Fund staff calculations.

38. **The poor quality of infrastructure is a major impediment to investment and productivity**. Over the past 15 years, public investment grew much less than current spending, while private financing of infrastructure was very limited. This has led to a severe infrastructure gaps, including in transportation and energy production (IMF 2016).[12] Access to appropriate infrastructure in terms of roads, railways, ports and energy is especially important for exporting firms outside the central region and metropolitan areas (see Selected Issues Paper, Chapter 6).[13] Filling the infrastructure gap will take time and, given the limited scope for a significant expansion of public spending, would require initiatives to improve the institutional and legal framework for private sector participation in infrastructure projects, including by introducing a well-functioning, transparent, and competitive system of concessions.

**Change in Export Market Share and Transport Infrastructure**




Sources: Direction of Trade Statistics and Global Competitiveness Report (2014).

39. **Investment could be encouraged by reformulating the regulatory structure for utilities and creating a more competitive crude oil and natural gas industry**. The authorities should

---

[11] As just one comparative indicator, Argentina has trade agreements with 43 countries, while Chile has agreements with 91 countries. Colombia, Chile, and Peru, for example, have signed FTAs with the U.S., Canada, the EU, the EFTA, and Korea, while MERCOSUR has been negotiating toward an FTA with the EU for almost 20 years without concluding an agreement. Among the G20, Argentina has an FTA only with Brazil.

[12] Valerie Cerra and others, "*Highways to Heaven: Infrastructure Determinants and Trends in Latin America and the Caribbean*", 2016, IMF Working paper, n.185.

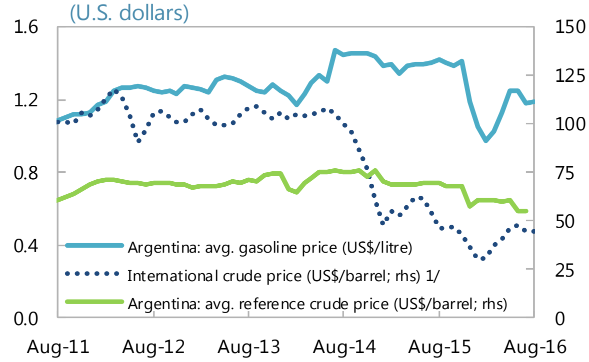
[13] The logistic cost of exporting a 40-foot container by land is US$1,842 in Argentina compared to US$1,000 in Brazil, with data as of 2014 (World Bank, 2015). Countries improving their score by 1 in the logistic performance index (LPI) increase their labor productivity by 35 percent on average (OECD, CAF, and ECLAC, 2013). All references are in Chapter 6 of the Selected Issues Paper.

establish an independent, rules-based regulatory structure for electricity generation, transmission, and distribution, water and sewage, and natural gas. This should include clear, transparent, and predictable mechanisms for adjusting tariffs. In addition, there should be accountability for the quality of services and requirements to maintain the underlying infrastructure.

- *Natural gas*. The 3-year plan for increasing natural gas tariffs for residential customers goes in the right direction, and discussions are ongoing to update the old gas plan that fixes the remuneration for natural gas producers and expires at end-2017. The old system (that remunerates investment done before 2012 at prices well below current import prices and gas produced with new investment at prices above current import prices) should be replaced by a plan that guarantees remuneration at international prices, with caps and floors to avoid excessive volatility, for a sufficiently long period of time so as to encourage investment in exploration and production.

- *Crude oil prices* are also regulated by agreement between the government, refiners, and the oil extraction companies, with companies currently guaranteed a domestic price of US$67 per barrel. The guaranteed price should be phased out and investment encouraged instead by better governance, a clear long-term roadmap for their development, and mechanisms to ensure transparency, accountability, stability, and the respect for contractual rights.

**Crude Oil and Gasoline Prices**
(U.S. dollars)




Sources: Energy Secretariat, Haver Analytics and World Economic Outlook.
1/ Avg. crude price of UK Brent, Dubai Medium, and Alaska NS Heavy.

- *For electricity*, the government plans to double the supply of effectively available electricity in the next decade and reach a target for renewable resources to cover 25 percent of the country's energy needs. Two public auctions have been implemented so far this year, which awarded 10 years PPAs (Power Purchases Agreements) on thermal energy projects, both of which attracted considerable interest also given the high rates of return offered. In the future, improving the regulatory framework would ensure a more competitive tender process, allowing further reductions in the cost of energy.

40. **Argentina fares poorly in the areas of market efficiency and competition**. This reflects the existence of anticompetitive regulation and barriers to entry (particularly in network industries), a weak antitrust framework, and significant and unpredictable government involvement in private industry. Important progress is ongoing at the Argentina's National Competition Commission, which has recently been restructured. A law has been sent to Congress that makes the Commission independent, giving it a clear mandate to conduct investigations, and impose fines, and bring cases to court. The legislation also introduces leniency programs to incentivize whistleblowing; updates the thresholds for fines and merger and acquisition cases (that had not been adjusted for inflation over the past decade); and introduces a special chamber in the judiciary to adjudicate on competition cases. The Commission has already issued a report to Congress on the state of

competition in the credit card industry and will follow up with studies on dominant position and collusive behavior in other 13 sectors. The authorities have announced a *Plan Productivo Nacional* that delineates an active industrial policy, aimed at maintaining or strengthening public support to sectors deemed competitive (such as the automotive sector) and gradually eliminating it for uncompetitive sectors (such as the electronic cluster in Terra del Fuego). The exact contours of the plan have yet to be defined but should avoid an excessively active (i.e., picking-winners) industrial policy. Instead, policy should seek to level the playing field by removing government support across all sectors and lowering the tax burden more broadly.

41. **Progress on supply-side reforms could generate significant pay-offs for medium-term growth and jobs**. An extensive literature finds that structural reforms, including product market reforms, have a positive impact on growth over the medium and long term (IMF, 2015).[14] In Argentina, a number of reforms could be achieved through legislative changes at little or no fiscal cost. Financial liberalization would support both consumption and investment by relaxing credit constraints. Similarly, improving the regulatory framework and reducing barriers to entry and the costs of doing business would stimulate FDI and productivity. Using OECD estimates on the impact (after 10 years) of product market reforms (proxied by an indicator of regulation in network industries) on GDP levels suggests that closing half the gap between Argentina and the OECD average could add 1½ percent to GDP by 2021 and 0.6 percent to employment.[15]

42. **Authorities' view**. The authorities agreed that fundamental supply-side reforms are needed to improve the business climate and create the conditions for a more integrated, competitive, productive, and inclusive economy. A multi-pillar *Agreement on Productivity and Jobs* has been articulated (following the *Plan Productivo Nacional*) that aims at establishing a broad consensus on measures to develop local capital markets, reduce cost of production, lower the tax burden, improve labor legislation, foster innovation, increase competition, reduce red tape, and boost infrastructure. While work in these areas has begun already, the authorities stressed that many of the reforms would need to be phased in gradually, taking into account their political and social implications. For example, removing costly and inefficient subsidies and protections for some sectors at a time when the private sector is not creating new jobs could imply excessive social and economic costs. Rather, it is preferable to try and incentivize a reallocation of resources from the least to the most productive sectors, or production processes within sectors. The authorities said they are negotiating with producers, provinces, and unions a gradual reduction of crude oil prices to international parity over the next few months. Regulatory agencies in the energy sector are being redirected to their original function, and new directors are being selected with more independence from political pressure. The authorities intend to launch an ambitious program of infrastructure, increasing government's capital spending from 2 to 6 percent of GDP in about 8 years, two thirds of which in partnership with the private sector. In order to achieve this objective a new law has been sent to

[14] "*Structural Reforms and Macroeconomic Performance: Initial Considerations for the Fund*". IMF Policy Paper, November 2015.

[15] Sebastian Barnes and others. "*The GDP Impact of Reform: A Simple Simulation Framework*," (2011), OECD Economics Department Working Papers, No. 834, OECD Publishing

Congress that aims at improving the institutional and legal framework for public-private partnerships, including by setting up a special unit that will assess the social return associated with these projects, as well as their macroeconomic and financial implications. Finally, the authorities are committed to further step-up their anti-corruption efforts. The Anti-Corruption Office has embarked on increasing transparency and accountability of government public officials by making public all financial asset disclosures. Together with financial sectors stakeholders, the authorities have also started utilizing the AML/CFT controls in advancing and supporting investigations and prosecutions of corruption.

# STAFF APPRAISAL

43. **Upon taking office in December last year, Argentina's new government inherited a legacy of pervasive macroeconomic imbalances, microeconomic distortions, and a weakened institutional framework**. These encompassed unsustainably high consumption levels, historically low levels of investment, and large fiscal deficits financed by money creation, which led to high inflation. Distortions at the micro level included an extensive network of administrative controls (for example, trade barriers, foreign exchange restrictions, and price controls) and a business environment that eroded competitiveness and undermined medium-term growth. There was also an important weakening of the institutional framework for economic policymaking, perhaps most evident in the loss of credibility of the national statistics agency.

44. **A necessary and unavoidable transition**. Confronted with this difficult situation, the new government began an ambitious and much needed transition toward a better economic policy framework, reversing the serious macroeconomic imbalances and microeconomic distortions inherited from the previous government. Important progress has been made. The peso is now market determined, and foreign exchange controls have been essentially eliminated. The increase in utility tariffs has brought prices more in line with underlying costs. The settlement with creditors has allowed a return to international capital markets by both the private and public sectors. Medium-term fiscal and inflation targets were announced in conjunction with a transition toward a modern system of inflation targeting. Finally, the national statistics agency is being rebuilt, allowing for the publication of improved and credible data on inflation, trade, labor market, and output.

45. **Near-term costs but a more favorable future**. The reversal of the serious imbalances and distortions inherited from the previous administration, while necessary to lay the foundation for robust future growth, unavoidably had an adverse near-term impact on the Argentine economy. Indeed, the current recession had begun even before the new administration took office. However, the alternative of continuing with the unsustainable policy framework of the past administration was simply not tenable and would have eventually led to a repeat of Argentina's history of crisis, contraction, and social distress. Staff expects the economy to emerge from recession in late 2016, and the planned fiscal consolidation in 2017 should be more-than-offset by a pickup in private consumption, an improving external environment, and a rebound of private investment. It is no accident that Argentina is forecast to experience one of the largest swings in growth—from negative to positive—in 2017, based on the October 2016 *World Economic Outlook*.

46. **With strong policy action and dramatic changes underway in the Argentine economy, the outlook is subject to greater than normal uncertainty**. On the upside, Argentina's private investment could prove to be more responsive to the measures taken so far to remove domestic distortions, particularly given the clear underinvestment in a range of sectors over the past several years. This would help with the fiscal position and would improve the outlook for long-term growth. On the downside, given the expected reliance on external debt, a tightening of global financial conditions could create pressures on the currency, affect the cost and availability of budgetary financing, and impose a faster pace of fiscal consolidation. Higher inflationary pressures from backward-looking nominal wage increases could lead to a more costly process of disinflation, which would slow the rebound of economic activity that is expected for next year.

47. **The government should be commended for its commitment to bring inflation down to single-digit levels**. The pace at which this disinflation is achieved should remain flexible and adapt to circumstances as they unfold, remaining conscious of the economic costs and, particularly, the distributional impact. To support these efforts, building credibility in the monetary policy framework, including through strengthening the institutional underpinning for policy will be essential and will serve to lessen the economic and social cost of lowering inflation. Positive steps continue to be taken by the national statistics agency in restoring the credibility of Argentina's statistics.

48. **The government's plan to lower the fiscal deficit remains a vital objective**. The pace and composition of this shift in the fiscal position will need to be sensitive to the impact on growth, jobs, and on the most vulnerable segments of the Argentine population. Frontloading the fiscal correction to the extent allowed by the current economic, political and social constraints would be desirable. Doing so will allow for a more accelerated reduction in interest rates, ease the current upward pressure on the real exchange rate, improve the public debt dynamics, and facilitate the needed rebalancing from consumption to investment-driven growth. There will have to be a rationalization of government spending, which has increased rapidly over the last decade. Much can be done to strengthen public expenditure management, improve governance, and increase the efficiency of public spending. Action is particularly needed on eliminating regressive energy subsidies, protecting the poorest part of the population, addressing actuarial imbalances in the pension system, and overhauling the inefficient and burdensome tax system. A clearer articulation to the public of the policy measures that underlie the targeted reduction of the federal deficit in 2017 as well as a simple, transparent and credible medium-term fiscal policy plan that guides expectations would both be valuable.

49. **Rebuilding the foundations for growth**. Strong, sustained, and equitable growth will require the implementation of an ambitious agenda of supply-side reforms. Near-term priorities include putting in place a better regulatory framework for energy and utilities, fully realigning utilities tariffs toward cost recovery while maintaining measures to protect the poor, and modernizing financial market infrastructure and regulation. There is also a broader need to scale back government involvement in private industries and create a better governance framework, including by making further progress on the government's ambitious anti-corruption plans. Such a set of policies will create an environment that is more conducive to private investment and will generate significant

medium-term dividends in terms of more and better jobs as well as a steady improvement in the living standards for Argentina's population.

50. **Staff proposes that the next Article IV Consultation take place on the standard 12-month cycle**.

## Table 1. Argentina: Selected Economic and Financial Indicators

| | Average 2009–14 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|
| | | | Proj. | | | | | |
| | | | *(Annual percentage changes unless otherwise indicated)* | | | | | |
| **National income, prices, and labor markets 1/ 2/** | | | | | | | | |
| GDP at constant prices | 1.5 | 2.5 | -1.8 | 2.7 | 2.8 | 2.9 | 3.1 | 3.3 |
| Domestic demand | 2.6 | 3.7 | -2.2 | 3.4 | 3.6 | 3.6 | 3.5 | 3.6 |
| Consumption | 2.8 | 4.1 | -1.8 | 2.3 | 2.7 | 2.7 | 2.9 | 3.0 |
| Private | 2.6 | 3.6 | -1.7 | 2.5 | 2.8 | 2.8 | 3.0 | 3.1 |
| Public | 4.5 | 6.6 | -2.5 | 1.6 | 2.1 | 2.4 | 2.5 | 2.5 |
| Investment | 1.6 | 4.2 | -3.6 | 8.2 | 7.2 | 7.2 | 5.9 | 5.8 |
| Exports | -1.0 | -0.6 | 4.5 | 4.4 | 4.8 | 3.8 | 5.5 | 4.8 |
| Imports | 4.4 | 5.6 | 1.3 | 6.8 | 7.6 | 6.3 | 6.3 | 5.6 |
| Change in inventories and stat. disc. (contribution to growth) | 0.1 | -0.3 | -0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Nominal GDP (billions of Argentine pesos) | 2,609 | 5,843 | 8,043 | 10,173 | 12,466 | 14,801 | 17,016 | 19,259 |
| CPI inflation (eop, y/y percent change) | ... | ... | 39.4 | 20.5 | 17.5 | 13.0 | 10.3 | 9.4 |
| Unemployment rate (percent) | 7.5 | ... | 9.2 | 8.5 | 8.3 | 7.5 | 6.9 | 6.8 |
| | | | *(Percent of GDP unless otherwise indicated)* | | | | | |
| **External sector** | | | | | | | | |
| Exports f.o.b. (goods, billions of U.S. dollars) | 71.9 | 56.8 | 55.3 | 57.2 | 59.5 | 62.0 | 65.6 | 68.9 |
| Imports f.o.b. (goods, billions of U.S. dollars) | -60.1 | -57.2 | -51.6 | -56.4 | -61.1 | -65.5 | -70.2 | -74.5 |
| Trade balance (goods, billions of U.S. dollars) | 11.7 | -0.4 | 3.8 | 0.8 | -1.5 | -3.5 | -4.5 | -5.6 |
| Trade balance (goods) | 2.6 | -0.1 | 0.7 | 0.1 | -0.2 | -0.5 | -0.6 | -0.7 |
| Terms of trade (percent change) | 1.6 | -4.0 | 2.3 | -2.9 | -1.6 | -0.4 | -0.4 | -0.2 |
| Total external debt | 31.4 | 25.2 | 31.7 | 32.5 | 33.8 | 34.5 | 34.6 | 34.6 |
| **Savings-Investment balance** | | | | | | | | |
| Gross domestic investment | 16.3 | 15.9 | 15.8 | 16.5 | 17.1 | 17.6 | 17.9 | 18.2 |
| Gross national savings | 15.9 | 13.4 | 13.5 | 13.3 | 13.5 | 13.7 | 13.9 | 14.0 |
| Current account balance | -0.4 | -2.5 | -2.3 | -3.2 | -3.6 | -3.9 | -4.0 | -4.2 |
| **Public sector 3/** | | | | | | | | |
| Primary balance | -1.7 | -5.4 | -5.6 | -5.1 | -4.1 | -3.0 | -2.0 | -1.8 |
| *of which*: Federal government | -1.4 | -5.0 | -4.8 | -4.5 | -3.6 | -2.5 | -1.4 | -1.3 |
| Overall balance | -2.7 | -6.6 | -7.3 | -6.9 | -6.2 | -5.0 | -3.8 | -3.6 |
| *of which*: Federal government | -2.4 | -6.2 | -6.5 | -6.3 | -5.6 | -4.4 | -3.2 | -3.0 |
| Revenues | 30.7 | 34.0 | 32.5 | 32.3 | 32.2 | 32.0 | 31.8 | 31.7 |
| Primary expenditure | 33.1 | 39.4 | 38.0 | 37.4 | 36.3 | 35.0 | 33.8 | 33.5 |
| Total public debt (federal) | 43.3 | 52.1 | 51.8 | 51.1 | 51.2 | 50.0 | 48.4 | 47.5 |
| **Money and credit** | | | | | | | | |
| Monetary base (eop, y/y percent change) | 27.5 | 34.9 | 24.4 | 23.7 | 20.7 | 16.5 | 13.8 | 12.8 |
| Credit to the private sector (eop, y/y percent change) | 28.9 | 35.6 | 26.4 | 21.2 | 18.4 | 14.8 | 15.3 | 14.0 |
| Credit to the private sector real (eop, y/y percent change) | ... | ... | -9.3 | 0.6 | 0.8 | 1.6 | 4.5 | 4.2 |
| LEBAC interest rate (average) 4/ | 16.0 | 28.1 | 29.8 | 25.2 | 20.1 | 16.3 | 13.7 | 13.1 |
| LEBAC real interest rate (average) 4/ | ... | ... | 5.0 | 5.1 | 4.4 | 4.4 | 3.7 | 3.4 |
| LEBAC interest rate (eop) 4/ | 16.3 | 32.2 | 28.3 | 22.8 | 17.7 | 15.1 | 13.2 | 13.0 |
| LEBAC real interest rate (eop) 4/ | ... | ... | 6.4 | 4.5 | 4.2 | 4.4 | 3.5 | 3.3 |
| **Memorandum items** | | | | | | | | |
| Gross international reserves (billions of U.S. dollars) | 42.0 | 25.6 | 33.3 | 36.5 | 49.2 | 56.5 | 61.2 | 66.6 |
| Exchange rate (eop, Arg$/US$) | 5.3 | 13.0 | ... | ... | ... | ... | ... | ... |
| Change in REER (average, percent change) | 6.7 | 26.0 | -12.8 | 3.7 | 2.9 | 2.9 | 2.9 | 2.9 |
| Transfers from BCRA | 0.9 | 1.3 | 1.4 | 0.6 | 0.2 | 0.1 | 0.0 | 0.0 |

Sources: Ministerio de Hacienda y Finanzas Públicas, Banco Central de la República Argentina (BCRA), and Fund staff estimates.

1/ On February 1, 2013, the IMF issued a declaration of censure, and since then has called on Argentina to implement specified actions to address the quality of its official GDP data. The new government that took office in December 2015 released a revised GDP series on June 29, 2016. At the IMF Executive Board meeting that took place on August 31, 2016, the revised series was considered to be in line with international standards.

2/ The consumer price data for Argentina before December 2013 reflect the CPI for the Greater Buenos Aires Area (CPI-GBA), while from December 2013 to October 2015 the data reflect the national CPI (IPCNu). The new government that took office in December 2015 discontinued the IPCNu stating that it was flawed and released a new CPI for the Greater Buenos Aires Area on June 15, 2016. Given the differences in geographical coverage, weights, sampling, and methodology of these series, the average CPI inflation for 2014, 2015, and 2016 and end-of-period inflation for 2015 are not reported in the October 2016 World Economic Outlook. On February 1, 2013, the IMF issued a declaration of censure and since then has called on Argentina to implement specified actions to address the quality of its official CPI data. At the meeting that took place on August 31, 2016, the IMF Executive Board noted the important progress made in strengthening the accuracy of the CPI data. The Managing Director will report to the Executive Board on this issue again by November 15, 2016. The Executive Board discussion on this issue will take place on November 9, 2016.

3/ The primary balance excludes profit transfers from the central bank of Argentina. Interest expenditure is net of property income from the social security fund.

4/ Average of LEBAC rates of all maturities.

## Table 2. Argentina: Summary Balance of Payments, 2011–21

| | | | | | | Proj. | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
| | *(Billions of U.S. dollars)* | | | | | | | | | | |
| **Current account** | **-4.4** | **-1.4** | **-12.1** | **-8.0** | **-15.9** | **-12.7** | **-19.3** | **-23.4** | **-27.7** | **-31.2** | **-35.2** |
| Trade balance | 12.2 | 14.9 | 4.7 | 6.0 | -0.4 | 3.8 | 0.8 | -1.5 | -3.5 | -4.5 | -5.6 |
| Exports f.o.b. | 83.0 | 80.0 | 76.0 | 68.4 | 56.8 | 55.3 | 57.2 | 59.5 | 62.0 | 65.6 | 68.9 |
| Primary products | 19.8 | 19.0 | 17.8 | 14.2 | 13.3 | 13.9 | 14.3 | 14.4 | 14.7 | 14.9 | 15.2 |
| Manufactures of agricultural origin | 27.7 | 26.8 | 27.0 | 26.4 | 23.3 | 23.1 | 23.4 | 23.5 | 24.0 | 24.4 | 24.8 |
| Manufactures of industrial origin | 28.8 | 27.2 | 25.6 | 22.8 | 18.0 | 16.4 | 17.4 | 19.7 | 21.6 | 24.7 | 27.6 |
| Energy | 6.7 | 7.0 | 5.6 | 5.0 | 2.3 | 1.9 | 2.1 | 1.9 | 1.7 | 1.5 | 1.4 |
| Imports f.o.b. | -70.8 | -65.0 | -71.3 | -62.4 | -57.2 | -51.6 | -56.4 | -61.1 | -65.5 | -70.2 | -74.5 |
| Capital goods | -27.3 | -25.1 | -26.6 | -23.7 | -23.4 | -22.0 | -24.4 | -26.7 | -29.1 | -31.5 | -33.7 |
| Intermediate goods | -20.9 | -19.0 | -18.7 | -17.8 | -17.3 | -15.1 | -16.1 | -17.1 | -18.2 | -19.5 | -20.8 |
| Consumer goods | -13.2 | -12.3 | -14.1 | -9.9 | -10.0 | -10.0 | -10.6 | -11.4 | -11.8 | -12.3 | -12.5 |
| Fuels and lubricants | -9.4 | -8.7 | -11.9 | -11.0 | -6.5 | -4.5 | -5.3 | -5.9 | -6.4 | -6.9 | -7.4 |
| Services, income and transfers | -16.6 | -16.3 | -16.7 | -14.0 | -15.6 | -16.5 | -20.2 | -21.8 | -24.2 | -26.7 | -29.6 |
| Services balance | -2.2 | -3.0 | -3.7 | -3.1 | -3.9 | -4.6 | -4.9 | -5.3 | -5.4 | -5.5 | -5.6 |
| Earnings and dividends, net | -10.7 | -9.2 | -8.6 | -6.9 | -7.6 | -7.1 | -8.0 | -9.1 | -10.6 | -12.4 | -14.6 |
| Interests, net | -3.1 | -3.6 | -3.6 | -3.9 | -3.6 | -4.4 | -6.9 | -7.1 | -7.9 | -8.5 | -9.2 |
| Other flows and transfers | -0.6 | -0.5 | -0.8 | -0.2 | -0.4 | -0.3 | -0.3 | -0.3 | -0.3 | -0.3 | -0.3 |
| **Capital and financial account** | **-1.7** | **-1.7** | **3.1** | **18.5** | **12.3** | **25.8** | **31.2** | **36.1** | **35.0** | **35.9** | **40.6** |
| Capital account | 0.1 | 0.0 | 0.0 | 0.1 | 0.1 | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| Portfolio investment, net | -3.9 | -4.1 | -0.3 | 6.4 | -0.5 | 28.2 | 18.6 | 19.2 | 14.3 | 11.0 | 11.8 |
| *of which:* public sector | -3.4 | -3.1 | -0.9 | 5.8 | -2.6 | 23.6 | 15.6 | 21.2 | 17.9 | 14.6 | 15.4 |
| Foreign direct investment, net | 9.4 | 14.3 | 8.9 | 3.1 | 11.1 | 6.3 | 9.8 | 13.4 | 17.6 | 21.6 | 25.7 |
| Other investment, net | -7.2 | -11.9 | -5.6 | 9.0 | 1.6 | -8.8 | 2.7 | 3.5 | 3.1 | 3.2 | 3.1 |
| **Errors and omissions** | **0.3** | **-0.5** | **-3.2** | **-0.2** | **-1.3** | **-1.1** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** |
| **Overall balance** | **-5.8** | **-3.6** | **-12.2** | **10.3** | **-4.9** | **16.7** | **3.2** | **12.7** | **7.3** | **4.7** | **5.4** |
| **Financing** | **5.8** | **3.6** | **12.2** | **-10.3** | **5.0** | **-16.7** | **-3.2** | **-12.7** | **-7.3** | **-4.7** | **-5.4** |
| Change in gross reserves (increase -) | 5.8 | 3.1 | 12.7 | -0.8 | 5.9 | -7.7 | -3.2 | -12.7 | -7.3 | -4.7 | -5.4 |
| Valuation changes and arrears | 0.0 | 0.5 | -0.5 | -9.5 | -0.9 | -9.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| | *(Percent of GDP unless otherwise indicated)* | | | | | | | | | | |
| **Current account** | **-0.8** | **-0.2** | **-2.0** | **-1.4** | **-2.5** | **-2.3** | **-3.2** | **-3.6** | **-3.9** | **-4.0** | **-4.2** |
| Trade balance | 2.3 | 2.6 | 0.8 | 1.1 | -0.1 | 0.7 | 0.1 | -0.2 | -0.5 | -0.6 | -0.7 |
| Exports, f.o.b. | 15.7 | 13.8 | 12.4 | 12.1 | 9.0 | 10.2 | 9.6 | 9.1 | 8.7 | 8.5 | 8.2 |
| Imports f.o.b. | -13.4 | -11.2 | -11.7 | -11.1 | -9.1 | -9.5 | -9.5 | -9.4 | -9.2 | -9.1 | -8.9 |
| **Capital and financial account** | **-0.3** | **-0.3** | **0.5** | **3.3** | **2.0** | **4.8** | **5.2** | **5.5** | **4.9** | **4.6** | **4.8** |
| Portfolio investment, net | -0.7 | -0.7 | -0.1 | 1.1 | -0.1 | 5.2 | 3.1 | 2.9 | 2.0 | 1.4 | 1.4 |
| Foreign direct investment, net | 1.8 | 2.5 | 1.5 | 0.6 | 1.8 | 1.2 | 1.6 | 2.1 | 2.5 | 2.8 | 3.1 |
| Other investment, net | -1.4 | -2.1 | -0.9 | 1.6 | 0.3 | -1.6 | 0.5 | 0.5 | 0.4 | 0.4 | 0.4 |
| **Memorandum items:** | | | | | | | | | | | |
| Non-interest current account balance (US$bns) | -1.3 | 2.2 | -8.4 | -4.1 | -12.3 | -8.3 | -12.4 | -16.3 | -19.8 | -22.7 | -26.0 |
| Non-interest current account balance (% of GDP) | -0.3 | 0.4 | -1.4 | -0.7 | -2.0 | -1.5 | -2.1 | -2.5 | -2.8 | -2.9 | -3.1 |
| Exports volumes (percent change) | 3.4 | -6.9 | -3.7 | -7.8 | -1.7 | 5.7 | 4.3 | 4.8 | 3.8 | 5.5 | 4.8 |
| Imports volumes (percent change) | 22.1 | -6.9 | 3.7 | -12.5 | 3.8 | 0.2 | 7.0 | 7.4 | 6.6 | 6.2 | 5.7 |
| Terms of trade (Index, 2004 = 100) | 139.3 | 144.7 | 135.3 | 131.6 | 126.3 | 129.3 | 125.5 | 123.5 | 123.0 | 122.4 | 122.2 |
| Change in REER (average, percent change) | 10.2 | 20.9 | 4.3 | -6.1 | 26.0 | -12.8 | 3.7 | 2.9 | 2.9 | 2.9 | 2.9 |
| Gross international reserves (US$bns) | 46.4 | 43.3 | 30.6 | 31.4 | 25.6 | 33.3 | 36.5 | 49.2 | 56.5 | 61.2 | 66.6 |
| (in months of imports of goods and services) | 6.3 | 6.2 | 4.1 | 4.8 | 4.1 | 5.7 | 5.8 | 7.3 | 8.0 | 8.2 | 8.5 |

Sources: INDEC and Fund staff estimates.

## Table 3. Argentina: Consolidated Public Sector Operations, 2011–21[1/]

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 Proj. | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | *(Billions of Argentine pesos)* | | | | | |
| **Revenues** | **666,572** | **845,661** | **1,092,211** | **1,485,461** | **1,985,132** | **2,610,483** | **3,290,820** | **4,013,204** | **4,735,401** | **5,417,725** | **6,104,841** |
| Tax revenues | 485,168 | 612,917 | 792,089 | 1,074,207 | 1,427,152 | 1,865,919 | 2,360,382 | 2,873,121 | 3,381,759 | 3,861,476 | 4,343,488 |
| Social security contributions | 134,220 | 175,590 | 229,767 | 297,504 | 401,045 | 565,340 | 715,121 | 876,252 | 1,040,391 | 1,196,111 | 1,353,751 |
| Other revenues | 47,184 | 57,153 | 70,355 | 113,749 | 156,935 | 179,224 | 215,316 | 263,831 | 313,252 | 360,138 | 407,602 |
| **Primary Expenditures** | **696,932** | **884,694** | **1,172,133** | **1,633,714** | **2,301,838** | **3,057,283** | **3,807,587** | **4,525,485** | **5,185,657** | **5,751,094** | **6,456,605** |
| Wages | 227,576 | 294,392 | 378,231 | 523,683 | 737,876 | 1,011,357 | 1,279,306 | 1,581,432 | 1,900,198 | 2,210,252 | 2,501,549 |
| Goods and services | 53,335 | 64,257 | 86,279 | 120,322 | 157,827 | 203,277 | 257,133 | 302,605 | 344,488 | 362,017 | 371,212 |
| Transfers to the private sector | 277,235 | 356,044 | 466,110 | 663,035 | 927,581 | 1,278,410 | 1,589,976 | 1,831,725 | 2,038,774 | 2,260,704 | 2,544,720 |
| *Of which:* federal pensions | 147,085 | 204,617 | 272,066 | 363,385 | 535,697 | 712,389 | 991,129 | 1,214,450 | 1,441,940 | 1,657,762 | 1,876,244 |
| Capital spending | 77,671 | 83,176 | 120,990 | 171,594 | 209,423 | 311,093 | 411,825 | 504,618 | 599,142 | 688,818 | 779,600 |
| Other | 61,116 | 86,825 | 120,522 | 155,081 | 269,130 | 253,146 | 269,347 | 305,105 | 303,055 | 229,303 | 259,524 |
| **Primary balance** | **-30,360** | **-39,033** | **-79,922** | **-148,254** | **-316,706** | **-446,799** | **-516,768** | **-512,281** | **-450,256** | **-333,369** | **-351,764** |
| Interest cash | 25,239 | 34,879 | 20,563 | 34,453 | 70,710 | 137,747 | 188,078 | 258,921 | 288,284 | 312,583 | 338,913 |
| **Overall balance** | **-55,600** | **-73,912** | **-100,486** | **-182,707** | **-387,416** | **-584,547** | **-704,846** | **-771,202** | **-738,540** | **-645,952** | **-690,677** |
| | | | | | | *(Percent of GDP)* | | | | | |
| **Revenues** | **30.6** | **32.1** | **32.6** | **32.4** | **34.0** | **32.5** | **32.3** | **32.2** | **32.0** | **31.8** | **31.7** |
| Tax revenues | 22.3 | 23.2 | 23.7 | 23.5 | 24.4 | 23.2 | 23.2 | 23.0 | 22.8 | 22.7 | 22.6 |
| Social security contributions | 6.1 | 6.6 | 6.9 | 6.6 | 7.2 | 7.0 | 7.0 | 7.0 | 7.0 | 7.0 | 7.0 |
| Other revenues | 2.2 | 2.2 | 2.1 | 2.4 | 2.4 | 2.2 | 2.1 | 2.1 | 2.1 | 2.1 | 2.1 |
| **Primary expenditures** | **32.0** | **33.5** | **35.0** | **35.7** | **39.4** | **38.0** | **37.4** | **36.3** | **35.0** | **33.8** | **33.5** |
| Wages | 10.4 | 11.2 | 11.3 | 11.4 | 12.6 | 12.6 | 12.6 | 12.7 | 12.8 | 13.0 | 13.0 |
| Goods and services | 2.4 | 2.4 | 2.6 | 2.6 | 2.7 | 2.5 | 2.5 | 2.4 | 2.3 | 2.1 | 1.9 |
| Transfers to the private sector | 12.7 | 13.5 | 13.9 | 14.5 | 15.9 | 15.9 | 15.6 | 14.7 | 13.8 | 13.3 | 13.2 |
| *Of which:* federal pensions | 6.8 | 7.8 | 8.1 | 7.9 | 9.2 | 8.9 | 9.7 | 9.7 | 9.7 | 9.7 | 9.7 |
| Capital spending | 3.6 | 3.2 | 3.6 | 3.7 | 3.6 | 3.9 | 4.0 | 4.0 | 4.0 | 4.0 | 4.0 |
| Other | 2.8 | 3.3 | 3.6 | 3.4 | 4.6 | 3.1 | 2.6 | 2.4 | 2.0 | 1.3 | 1.3 |
| **Primary balance** | **-1.4** | **-1.5** | **-2.4** | **-3.2** | **-5.4** | **-5.6** | **-5.1** | **-4.1** | **-3.0** | **-2.0** | **-1.8** |
| Interest cash | 1.2 | 1.3 | 0.6 | 0.8 | 1.2 | 1.7 | 1.8 | 2.1 | 1.9 | 1.8 | 1.8 |
| **Overall balance** | **-2.6** | **-2.8** | **-3.0** | **-4.0** | **-6.6** | **-7.3** | **-6.9** | **-6.2** | **-5.0** | **-3.8** | **-3.6** |
| **Cyclically-adjusted primary balance** | **-2.4** | **-1.6** | **-2.9** | **-2.8** | **-5.8** | **-4.8** | **-4.3** | **-3.2** | **-2.0** | **-0.9** | **-0.8** |

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

1/ The primary balance excludes profit transfers from the central bank of Argentina. Interest expenditure is net of property income from the social security fund.

## Table 4. Argentina: Federal Government Operations, 2011–21[1/]

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | Proj. | | | | | |
| | | | | | | *(Billions of Argentine pesos)* | | | | | |
| **Revenues** | **541,494** | **687,143** | **874,966** | **1,175,494** | **1,591,344** | **2,068,379** | **2,605,091** | **3,172,967** | **3,737,772** | **4,270,776** | **4,806,730** |
| Tax revenues | 392,266 | 491,705 | 616,621 | 833,132 | 1,107,273 | 1,425,544 | 1,803,334 | 2,190,558 | 2,571,340 | 3,288,975 | 1,370,711 |
| Social security contributions | 133,680 | 174,388 | 229,890 | 300,889 | 419,419 | 564,169 | 715,121 | 876,252 | 1,040,391 | 1,353,751 | 519,758 |
| Nontax revenues | 15,547.7 | 21,050.0 | 28,454.5 | 41,472.7 | 64,652.5 | 78,666.3 | 86,635.8 | 106,156.6 | 126,041.7 | 164,004.8 | 70,291.2 |
| **Primary Expenditures** | **558,184** | **721,926** | **959,133** | **1,324,592** | **1,883,001** | **2,455,111** | **3,061,905** | **3,617,381** | **4,107,768** | **4,512,269** | **5,054,511** |
| Federal expenditures | 394,931 | 517,853 | 689,298 | 970,001 | 1,387,736 | 1,793,977 | 2,260,449 | 2,640,803 | 2,925,404 | 3,194,961 | 3,563,589 |
| Wages | 74,314 | 95,957 | 122,611 | 171,923 | 236,817 | 321,694 | 406,923 | 498,611 | 592,010 | 680,619 | 770,320 |
| Goods and services | 23,952 | 29,257 | 41,001 | 58,475 | 78,907 | 94,651 | 119,728 | 134,239 | 144,584 | 132,193 | 111,098 |
| Pensions | 147,085 | 204,617 | 272,066 | 363,385 | 535,697 | 712,389 | 991,129 | 1,214,450 | 1,441,940 | 1,657,762 | 1,876,244 |
| Transfers to private sector | 103,586 | 119,473 | 154,107 | 245,178 | 322,377 | 470,350 | 477,829 | 468,989 | 420,772 | 400,528 | 439,385 |
| Capital | 30,477 | 37,202 | 54,256 | 79,343 | 91,707 | 107,245 | 153,970 | 188,663 | 224,003 | 257,531 | 291,472 |
| Other | 15,516 | 31,346 | 45,257 | 51,696 | 122,232 | 87,648 | 110,869 | 135,850 | 102,095 | 66,329 | 75,070 |
| Transfers to provinces | 163,253 | 199,745 | 263,255 | 361,496 | 495,266 | 661,134 | 801,456 | 976,578 | 1,182,363 | 1,317,309 | 1,490,922 |
| Automatic | 123,239 | 156,731 | 204,149 | 280,205 | 398,471 | 542,506 | 702,265 | 879,969 | 1,067,658 | 1,253,498 | 1,418,701 |
| Coparticipation | 108,879 | 137,498 | 178,629 | 242,981 | 331,933 | 459,102 | 596,764 | 750,696 | 914,169 | 1,077,036 | 1,218,983 |
| Discretionary | 34,991 | 36,928 | 51,098 | 70,259 | 96,795 | 118,628 | 99,191 | 96,609 | 114,706 | 63,810 | 72,220 |
| **Primary balance** | **-16,690** | **-30,455** | **-77,588** | **-156,003** | **-291,658** | **-386,732** | **-456,814** | **-444,414** | **-369,996** | **-241,494** | **-247,780** |
| Interest cash | 24,429 | 33,743 | 19,071 | 32,135 | 68,640 | 134,834 | 184,299 | 254,226 | 282,529 | 305,564 | 330,420 |
| **Overall balance** | **-41,119** | **-64,197** | **-96,658** | **-188,138** | **-360,298** | **-521,566** | **-641,112** | **-698,640** | **-652,525** | **-547,057** | **-578,200** |
| | | | | | | *(Percent of GDP)* | | | | | |
| **Revenues** | **24.9** | **26.0** | **26.1** | **25.7** | **27.2** | **25.7** | **25.6** | **25.5** | **25.3** | **25.1** | **25.0** |
| Tax revenues | 18.0 | 18.6 | 18.4 | 18.2 | 18.9 | 17.7 | 17.7 | 17.6 | 17.4 | 17.2 | 17.1 |
| Social security contributions | 6.1 | 6.6 | 6.9 | 6.6 | 7.2 | 7.0 | 7.0 | 7.0 | 7.0 | 7.0 | 7.0 |
| Nontax revenues | 0.7 | 0.8 | 0.8 | 0.9 | 1.1 | 1.0 | 0.9 | 0.9 | 0.9 | 0.9 | 0.9 |
| **Primary expenditures** | **25.6** | **27.2** | **28.4** | **29.1** | **32.2** | **30.5** | **30.1** | **29.0** | **27.8** | **26.5** | **26.2** |
| Primary expenditures (excluding provinces) | 18.1 | 19.6 | 20.6 | 21.2 | 23.7 | 22.3 | 22.2 | 21.2 | 19.8 | 18.8 | 18.5 |
| Wages | 3.4 | 3.6 | 3.7 | 3.8 | 4.1 | 4.0 | 4.0 | 4.0 | 4.0 | 4.0 | 4.0 |
| Goods and services | 1.1 | 1.1 | 1.2 | 1.3 | 1.4 | 1.2 | 1.2 | 1.1 | 1.0 | 0.8 | 0.6 |
| Pensions | 6.8 | 7.8 | 8.1 | 7.9 | 9.2 | 8.9 | 9.7 | 9.7 | 9.7 | 9.7 | 9.7 |
| Private sector transfers | 4.8 | 4.5 | 4.6 | 5.4 | 5.5 | 5.8 | 4.7 | 3.8 | 2.8 | 2.4 | 2.3 |
| Capital | 1.4 | 1.4 | 1.6 | 1.7 | 1.6 | 1.3 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 |
| Other | 0.7 | 1.2 | 1.4 | 1.1 | 2.1 | 1.1 | 1.1 | 1.1 | 0.7 | 0.4 | 0.4 |
| Transfers to provinces | 7.3 | 7.3 | 7.6 | 7.7 | 8.5 | 8.2 | 7.9 | 7.8 | 8.0 | 7.7 | 7.7 |
| Automatic | 5.7 | 5.9 | 6.1 | 6.1 | 6.8 | 6.7 | 6.9 | 7.1 | 7.2 | 7.4 | 7.4 |
| Coparticipation | 5.0 | 5.2 | 5.3 | 5.3 | 5.7 | 5.7 | 5.9 | 6.0 | 6.2 | 6.3 | 6.3 |
| Discretionary | 1.6 | 1.4 | 1.5 | 1.5 | 1.7 | 1.5 | 1.0 | 0.8 | 0.8 | 0.4 | 0.4 |
| **Primary balance** | **-0.8** | **-1.2** | **-2.3** | **-3.4** | **-5.0** | **-4.8** | **-4.5** | **-3.6** | **-2.5** | **-1.4** | **-1.3** |
| Interest cash | 1.1 | 1.3 | 0.6 | 0.7 | 1.2 | 1.7 | 1.8 | 2.0 | 1.9 | 1.8 | 1.7 |
| **Overall balance** | **-1.9** | **-2.4** | **-2.9** | **-4.1** | **-6.2** | **-6.5** | **-6.3** | **-5.6** | **-4.4** | **-3.2** | **-3.0** |
| **Cyclically-adjusted primary balance** | **-1.5** | **-1.3** | **-2.8** | **-3.0** | **-5.3** | **-4.2** | **-3.9** | **-2.9** | **-1.7** | **-0.6** | **-0.4** |

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

1/ The primary balance excludes profit transfers from the central bank of Argentina. Interest expenditure is net of property income from the social security fund.

## Table 5. Argentina: Summary Operations of the Financial System, 2011–21

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

| | | | | | | Proj. | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
| | | | | | | I. Central Bank | | | | | |
| **Net foreign assets** | 172.9 | 193.0 | 183.5 | 219.0 | 157.5 | 287.1 | 378.8 | 678.2 | 882.1 | 1,025.2 | 1,199.9 |
| **Net domestic assets** | 50.0 | 114.4 | 193.7 | 243.5 | 466.4 | 488.7 | 580.6 | 479.8 | 466.9 | 510.1 | 532.3 |
| Credit to the public sector (net) | 191.5 | 311.7 | 472.2 | 697.7 | 1,194.4 | 1,431.1 | 1,649.3 | 1,901.4 | 2,089.4 | 2,231.6 | 2,349.6 |
| Credit to the financial sector (net) | -82.2 | -115.6 | -162.9 | -265.1 | -375.8 | -457.9 | -519.8 | -705.2 | -831.5 | -913.6 | -991.8 |
| Official capital and other items (net) | -59.3 | -81.8 | -115.7 | -189.1 | -352.2 | -484.6 | -549.0 | -716.3 | -791.0 | -807.9 | -825.6 |
| **Monetary base** | 222.9 | 307.4 | 377.2 | 462.6 | 623.9 | 775.8 | 959.4 | 1,158.0 | 1,349.1 | 1,535.3 | 1,732.2 |
| Currency issued | 173.1 | 237.0 | 289.2 | 358.8 | 478.8 | 595.4 | 736.2 | 888.6 | 1,035.3 | 1,178.2 | 1,329.3 |
| Bank deposits at the Central Bank | 49.9 | 70.3 | 88.0 | 103.8 | 145.1 | 180.5 | 223.1 | 269.3 | 313.8 | 357.1 | 402.9 |
| | | | | | | II. Consolidated Financial System | | | | | |
| **Net foreign assets** | 168.3 | 195.9 | 182.5 | 218.6 | 155.9 | 280.2 | 373.7 | 675.1 | 881.7 | 1,027.9 | 1,205.9 |
| **Net domestic assets** | 308.6 | 439.9 | 620.1 | 815.3 | 1,330.7 | 1,641.6 | 2,047.5 | 2,290.5 | 2,604.9 | 2,977.1 | 3,361.7 |
| Credit to the public sector (net) | 145.6 | 233.9 | 362.2 | 585.6 | 1,136.1 | 1,409.1 | 1,724.1 | 1,993.1 | 2,228.7 | 2,420.5 | 2,609.4 |
| Credit to the private sector | 305.3 | 401.3 | 526.7 | 633.0 | 858.3 | 1,085.0 | 1,315.5 | 1,557.4 | 1,787.5 | 2,060.3 | 2,349.6 |
| Net capital, reserves, and other assets | -142.2 | -195.4 | -268.8 | -403.3 | -663.7 | -852.5 | -992.0 | -1,260.1 | -1,411.3 | -1,503.6 | -1,597.3 |
| **Liabilities with the private sector** | 477.1 | 635.5 | 802.3 | 1,033.7 | 1,484.7 | 1,921.5 | 2,421.0 | 2,965.3 | 3,486.4 | 4,004.8 | 4,567.3 |
| Currency outside banks | 151.2 | 209.9 | 257.7 | 315.8 | 425.5 | 532.4 | 658.4 | 794.7 | 925.8 | 1,053.6 | 1,188.8 |
| Local currency deposits | 273.4 | 386.3 | 499.4 | 653.8 | 920.4 | 1,186.1 | 1,490.4 | 1,828.8 | 2,148.8 | 2,467.0 | 2,808.0 |
| Foreign currency deposits | 52.4 | 39.2 | 45.1 | 64.1 | 138.7 | 203.0 | 272.2 | 341.8 | 411.7 | 484.2 | 570.5 |
| | | | | | | *I. Central Bank (Percent of GDP)* | | | | | |
| **Net foreign assets** | 7.9 | 7.3 | 5.5 | 4.8 | 2.7 | 3.6 | 3.7 | 5.4 | 6.0 | 6.0 | 6.2 |
| **Net domestic assets** | 2.3 | 4.3 | 5.8 | 5.3 | 8.0 | 6.1 | 5.7 | 3.8 | 3.2 | 3.0 | 2.8 |
| Credit to the public sector (net) | 8.8 | 11.8 | 14.1 | 15.2 | 20.4 | 17.8 | 16.2 | 15.3 | 14.1 | 13.1 | 12.2 |
| Credit to the private sector | -3.8 | -4.4 | -4.9 | -5.8 | -6.4 | -5.7 | -5.1 | -5.7 | -5.6 | -5.4 | -5.1 |
| Official capital and other items (net) | -2.7 | -3.1 | -3.5 | -4.1 | -6.0 | -6.0 | -5.4 | -5.7 | -5.3 | -4.7 | -4.3 |
| **Monetary base** | 10.2 | 11.7 | 11.3 | 10.1 | 10.7 | 9.6 | 9.4 | 9.3 | 9.1 | 9.0 | 9.0 |
| Currency issued | 7.9 | 9.0 | 8.6 | 7.8 | 8.2 | 7.4 | 7.2 | 7.1 | 7.0 | 6.9 | 6.9 |
| Bank deposits at the central bank | 2.3 | 2.7 | 2.6 | 2.3 | 2.5 | 2.2 | 2.2 | 2.2 | 2.1 | 2.1 | 2.1 |
| | | | | | | *II. Consolidated Financial System (Percent of GDP)* | | | | | |
| **Net foreign assets** | 7.7 | 7.4 | 5.5 | 4.8 | 2.7 | 3.5 | 3.7 | 5.4 | 6.0 | 6.0 | 6.3 |
| **Net domestic assets** | 14.2 | 16.7 | 18.5 | 17.8 | 22.8 | 20.4 | 20.1 | 18.4 | 17.6 | 17.5 | 17.5 |
| Credit to the public sector (net) | 6.7 | 8.9 | 10.8 | 12.8 | 19.4 | 17.5 | 16.9 | 16.0 | 15.1 | 14.2 | 13.5 |
| Credit to the private sector | 14.0 | 15.2 | 15.7 | 13.8 | 14.7 | 13.5 | 12.9 | 12.5 | 12.1 | 12.1 | 12.2 |
| Net capital, reserves, and other assets | -6.5 | -7.4 | -8.0 | -8.8 | -11.4 | -10.6 | -9.8 | -10.1 | -9.5 | -8.8 | -8.3 |
| **Liabilities with the private sector** | 21.9 | 24.1 | 24.0 | 22.6 | 25.4 | 23.9 | 23.8 | 23.8 | 23.6 | 23.5 | 23.7 |
| Currency outside banks | 6.9 | 8.0 | 7.7 | 6.9 | 7.3 | 6.6 | 6.5 | 6.4 | 6.3 | 6.2 | 6.2 |
| Local currency deposits | 12.5 | 14.6 | 14.9 | 14.3 | 15.8 | 14.7 | 14.7 | 14.7 | 14.5 | 14.5 | 14.6 |
| Foreign currency deposits | 2.4 | 1.5 | 1.3 | 1.4 | 2.4 | 2.5 | 2.7 | 2.7 | 2.8 | 2.8 | 3.0 |
| | | | | | | *Changes in monetary base (y/y, in AR$ billion)* | | | | | |
| **Monetary base** | 62.5 | 84.4 | 69.8 | 85.4 | 161.3 | 151.9 | 183.5 | 198.6 | 191.1 | 186.2 | 196.9 |
| Foreign exchange purchases | | 41.1 | -16.1 | 81.9 | -69.5 | 127.6 | 48.9 | 241.8 | 151.0 | 102.4 | 124.3 |
| Public sector | 32.7 | 47.8 | 77.8 | 128.1 | 175.7 | 152.0 | 150.0 | 140.0 | 110.0 | 80.0 | 50.0 |
| Sterilization, (net) | 16.2 | -5.6 | 7.2 | -121.4 | -2.4 | -141.8 | -15.4 | -183.1 | -69.9 | 3.9 | 22.6 |
| Other items, net | 0.8 | 1.4 | 0.9 | -3.1 | 57.5 | 14.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| ***Memorandum items:*** | | | | | | | | | | | |
| M2 1/ | 381.1 | 534.1 | 670.5 | 867.3 | 1,103.7 | 1,422.2 | 1,758.7 | 2,122.8 | 2,473.1 | 2,814.5 | 3,175.5 |
| M2 (percent change) 1/ | 30.7 | 40.1 | 25.5 | 29.4 | 27.3 | 28.9 | 23.7 | 20.7 | 16.5 | 13.8 | 12.8 |
| Gross international reserves (US$ billions) | 46.4 | 43.3 | 30.6 | 31.4 | 25.6 | 33.3 | 36.5 | 49.2 | 56.5 | 61.2 | 66.6 |
| Credit to the private sector (eop, y/y percent change) | 44.8 | 31.5 | 31.2 | 20.2 | 35.6 | 26.4 | 21.2 | 18.4 | 14.8 | 15.3 | 14.0 |
| Credit to the private sector real (eop, y/y percent change) | … | … | … | … | … | -9.3 | 0.6 | 0.8 | 1.6 | 4.5 | 4.2 |
| Short-term deposit rate (BADLAR) 2/ | 13.4 | 13.8 | 17.0 | 22.6 | 21.6 | 27.7 | 23.7 | 17.7 | 15.1 | 13.2 | 13.0 |
| LEBAC interest rate (eop) 3/ | 14.1 | 13.8 | 16.4 | 28.5 | 32.2 | 28.3 | 22.8 | 17.7 | 15.1 | 13.2 | 13.0 |
| LEBAC real interest rate (eop) 3/ | … | … | … | … | … | 6.4 | 4.5 | 4.2 | 4.4 | 3.5 | 3.3 |

Sources: Banco Central de la República Argentina (BCRA) and Fund staff estimates.
1/ Currency in circulation outside banks plus peso-denominated deposits in checking and savings accounts.
2/ Average interest rate for 1-month time deposits over AR$1 million in private banks.
3/ Average of LEBAC rates of all maturities.

## Table 6. Argentina: External Debt, 2011–21

| | 2011 | 2012 | 2013 | 2014 | 2015 | Proj. 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | *(Billions of U.S. dollars)* | | | | | |
| **Total external debt** (gross; includes holdouts) | 156.3 | 157.2 | 153.0 | 156.4 | 158.6 | 172.4 | 193.1 | 220.0 | 245.0 | 267.8 | 290.8 |
| *Percent of GDP* | *29.7* | *27.1* | *25.0* | *27.8* | *25.2* | *31.7* | *32.5* | *33.8* | *34.5* | *34.6* | *34.6* |
| **By maturity** | | | | | | | | | | | |
| Long-term | 78.1 | 78.1 | 76.3 | 88.5 | 85.7 | 93.2 | 104.3 | 118.9 | 132.4 | 144.7 | 157.1 |
| Short-term (includes arrears) | 78.2 | 79.1 | 76.8 | 68.0 | 72.9 | 79.3 | 88.8 | 101.1 | 112.6 | 123.1 | 133.7 |
| Of which: Public sector | 12.7 | 10.9 | 10.7 | 4.6 | 12.2 | 13.2 | 14.8 | 16.9 | 18.8 | 20.5 | 22.3 |
| **By type of creditor** | | | | | | | | | | | |
| Debt to official creditors | 30.4 | 28.1 | 26.5 | 38.4 | 40.2 | 40.6 | 43.1 | 45.6 | 49.5 | 54.5 | 59.0 |
| Debt to banks | 8.9 | 9.0 | 8.3 | 7.5 | 7.0 | 7.6 | 8.6 | 9.8 | 10.9 | 11.9 | 12.9 |
| Debt to other private creditors | 117.0 | 120.1 | 118.1 | 110.6 | 111.3 | 124.1 | 141.4 | 164.6 | 184.6 | 201.4 | 218.9 |
| **By type of debtor** | | | | | | | | | | | |
| Official debt | 88.4 | 87.0 | 85.7 | 92.4 | 92.4 | 100.4 | 115.0 | 138.6 | 160.4 | 180.0 | 199.9 |
| Bank debt | 3.9 | 3.1 | 2.7 | 2.6 | 2.8 | 3.0 | 3.1 | 3.1 | 3.1 | 3.1 | 3.1 |
| Non-financial private sector | 64.0 | 67.1 | 64.6 | 61.4 | 63.3 | 69.1 | 75.1 | 78.3 | 81.5 | 84.7 | 87.9 |

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

## Table 7. Argentina: Public Debt, 2011–21

| | 2011 | 2012 | 2013 | 2014 | 2015 | Proj. 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | *(Billions of Argentine pesos)* | | | | | | | | | | |
| **Gross federal debt** | 829 | 1,040 | 1,413 | 1,996 | 3,046 | 4,162 | 5,203 | 6,377 | 7,400 | 8,233 | 9,141 |
| **By currency:** | | | | | | | | | | | |
| In domestic currency | 307 | 399 | 503 | 666 | 939 | 1,207 | 1,625 | 1,904 | 2,188 | 2,355 | 2,438 |
| In foreign currency | 522 | 642 | 910 | 1,330 | 2,107 | 2,955 | 3,578 | 4,473 | 5,212 | 5,877 | 6,704 |
| **By residency:** | | | | | | | | | | | |
| Held by external residents | 309 | 352 | 471 | 675 | 1,050 | 1,444 | 1,946 | 2,646 | 3,297 | 3,879 | 4,516 |
| Held by domestic residents | 509 | 675 | 925 | 1,321 | 1,996 | 2,718 | 3,257 | 3,731 | 4,103 | 4,353 | 4,626 |
| | *(Percent of GDP)* | | | | | | | | | | |
| **Gross federal debt** | 38.1 | 39.4 | 42.2 | 43.6 | 52.1 | 51.8 | 51.1 | 51.2 | 50.0 | 48.4 | 47.5 |
| **By currency:** | | | | | | | | | | | |
| In domestic currency | 14.1 | 15.1 | 15.0 | 14.5 | 16.1 | 15.0 | 16.0 | 15.3 | 14.8 | 13.8 | 12.7 |
| In foreign currency | 24.0 | 24.3 | 27.2 | 29.0 | 36.1 | 36.7 | 35.2 | 35.9 | 35.2 | 34.5 | 34.8 |
| **By residency:** | | | | | | | | | | | |
| Held by external residents 3/ | 14.2 | 13.4 | 14.1 | 14.7 | 18.0 | 18.0 | 19.1 | 21.2 | 22.3 | 22.8 | 23.4 |
| Held by domestic residents | 23.4 | 25.6 | 27.6 | 28.8 | 34.2 | 33.8 | 32.0 | 29.9 | 27.7 | 25.6 | 24.0 |

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

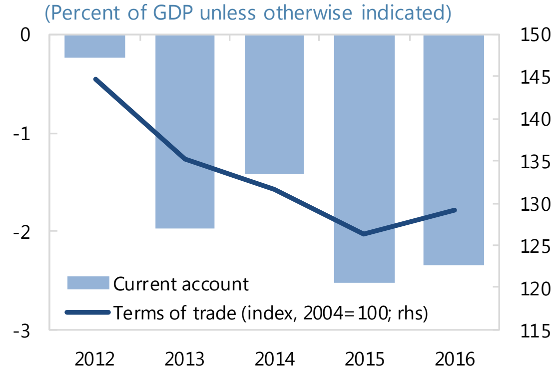
# Annex I. External Sector Assessment

*Argentina's external position is judged to be vulnerable to growing imbalances on the current account and exchange rate. The current account deficit is estimated to be about 2 percent of GDP above level implied by medium-term fundamentals and desirable policies. Since the 40 percent nominal devaluation in December 2015, the real exchange rate has undergone an important appreciation as strong capital inflows sustained a largely unchanged nominal exchange rate while a large wage and price inflation differential with trading partners eroded competitiveness. The Argentine peso is estimated to be overvalued by around 10–15 percent in 2016. Reserves are judged to be well below adequate levels, and the significant reliance on debt-creating portfolio capital flows (including to finance the public sector) makes Argentina vulnerable to a disruption to inward capital flows.*

## A. Current Account

**Argentina's current account (CA) balance deteriorated substantially in recent years**, from near balance in 2012 to -2½ percent of GDP in 2015. This reflected falling commodity prices and a nearly 50 percent real appreciation of the peso between 2012 and November 2015, that weakened competitiveness. A sharp worsening of the energy trade balance due to domestic policy distortions was also a factor.

**Current Account and Terms of Trade**
(Percent of GDP unless otherwise indicated)

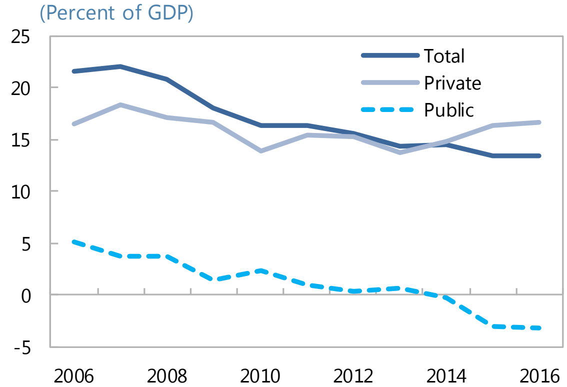



Sources: INDEC and Fund staff calculations and estimates.

**The worsening of the CA reflected a sharp decrease of national savings even as investment levels fell**. The strength in the peso, rising real wages, and accelerating inflation encouraged private consumption while the growth in current spending increased public sector dissaving. However, the true increase in external imbalances was masked by a range of controls.[1] These included a tight system of administrative controls to restrict both imports and the access to foreign exchange to make payments for those imports that were approved. The availability of FX to make dividend remittances was also limited. Since the new government took office in December 2015, most of the controls have been lifted (see Annex Table 1) although non-automatic import licenses still apply to a subset of products and services.

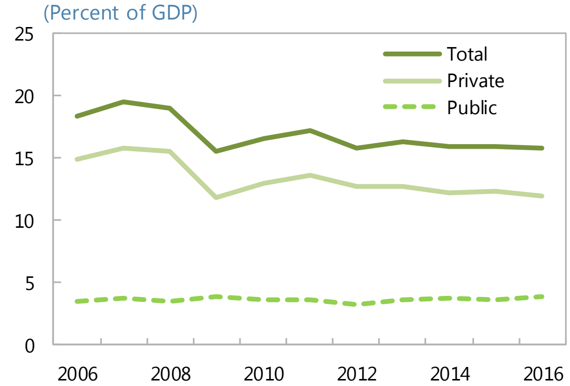
[1] Also, the non-payments to the 'holdout creditors' helped mask the current account deficit, as the unpaid interest on this debt was not included in the official current account balance.

**National Saving**
(Percent of GDP)




Sources: INDEC and Fund staff estimates.

**Domestic Investment**
(Percent of GDP)




Sources: INDEC and Fund staff estimates.

**The CA deficit is expected to worsen over the medium term**. The CA balance is expected to improve slightly in 2016 (-2.3 percent of GDP) as the peso devaluation and the removal of trade restrictions and export taxes were offset by weak external demand and higher net income outflows. However, from 2017 onward, the steady upward movement in the real exchange rate, increased dividends from higher FDI stocks, and higher debt service payment (as the public sector builds external debt) will cause the CA deficit to rise to 4.2 percent of GDP by 2021 (5.0 in cyclically-adjusted terms).[2]

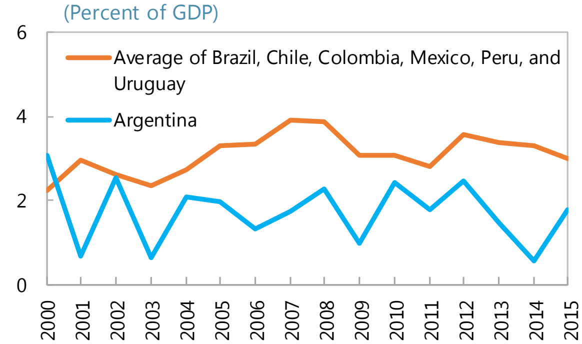
**While there is much uncertainty, the CA deficit in 2016 appears to be above levels consistent with medium-term fundamentals and desirable policies**. The CA assessment is made relative to the expected 2016 CA position given the significant external payments distortions present in the 2015 CA outturn (which were largely addressed in 2016). The CA-regression approach of using the EBA methodology yields a cyclically-adjusted CA norm of close to –1 percent of GDP. The desirable fiscal stance assumed in this estimate is based on a reduction of the overall general government fiscal deficit by about 4 percent of GDP over the medium term (consistent with the authorities' announced fiscal consolidation plans and staff's baseline). It also assumes an increase in the FX reserves over the medium term to close to US$70 billion. With a 2016 cyclically-adjusted CA expected to be about 2¾ percent of GDP, the CA gap in 2016 is estimated at about -1½ percent of GDP. The external stability (ES) approach suggests that the current account balance needed to stabilize the IIP position to the staff's estimated steady-state value is about -¾ percent of GDP.

[2] Prior to the exchange rate unification, staff and market estimates of FX overhang potentially arising from arrears on imports and dividend payments amounted to about US$8 billion and US$9 billion, respectively. However, as FX controls have been reduced since December 2015 and capital inflows to Argentina picked up, there has been little evidence of FX pressures from these sources, suggesting that the estimates of import arrears may have been overstated while dividends have likely been reinvested in the country.

## B. Capital and Financial Accounts

**Financial account restrictions, which had been building since 2002, reached a peak in 2011–15**. Access to foreign exchange for residents—including foreign exchange purchases for savings, direct investment abroad and commercial banks' foreign exchange position—was severely restricted to contain capital flight. The lack of access to international capital markets meant that foreign financing was largely limited to relatively low levels of FDI. Indeed, over the last 15 years, FDI net inflows to Argentina were almost half that of its peers (reflecting an unstable macroeconomic climate and weak investor confidence) leading to lower levels of leverage among both the public and private sectors.

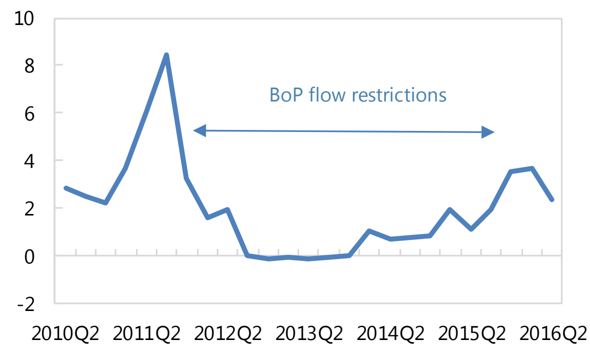
**FDI**
(Percent of GDP)




Sources: IMF, World Economic Outlook database and staff calculations.

**Despite controls, it is likely that significant capital left through informal channels**. Capital account controls likely led to increased circumvention of official channels to move resident assets abroad. While there is no directional bias in balance of payments 'errors and omissions', it is likely that substantial over-invoicing of imports payments occurred in the past. Furthermore, resident-held wealth, undeclared to the tax authorities, is thought to be substantial (although it is difficult to assess its evolution over time, given lack of data). For instance, International Investment Position (IIP) data indicates that 'other investment' foreign assets were US$210 billion in 2015 (only US$30 billion has been declared to the tax authorities).

**Capital Outflows**
(Billions of U.S. dollars)




Sources: INDEC and Fund staff calculations.

**Foreign exchange controls have all but been eliminated**. In December 2015, the authorities rolled back many of the formal and informal controls on foreign exchange transactions, and further steps were taken through August of this year to liberalize the system (see Annex Table 1). These steps not only lifted the restrictive system put in place in 2011 (the "cepo cambiario") but brought Argentina to its most liberal foreign exchange system since 2001.

**In the first half of 2016, the removal of most controls and a return to international markets have led to a significant increase in gross flows in both directions**. The removal of capital controls allowed residents to officially move money abroad on a large scale through formal channels for the first time since 2011 (estimated to be US$6 billion in 2016H1). In addition, in the first half of 2016 an agreement with creditors caused the federal government to issue US$19.3 billion of external debt to cover the principal payments on previously un-restructured debt (and the arrears on debt restructured under Argentina's 2005 and 2010 debt exchange) and for federal budget financing.

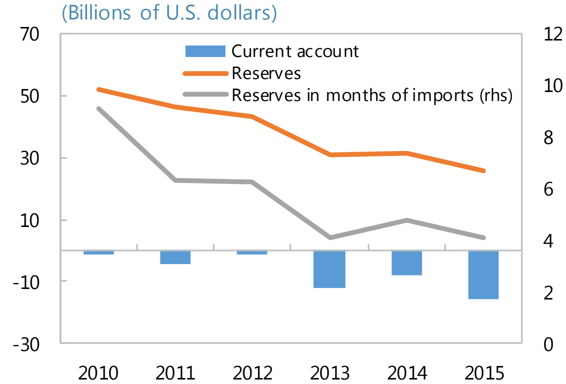
**For the remainder of 2016, public external debt issuance should subside, and capital outflows will moderate**. The authorities are unlikely to issue any substantial new external debt for the remainder of the year. Some external assets are assumed to be repatriated in order to purchase domestically issued debt. This includes inflows from abroad to take advantage of the proposed tax amnesty, which is assumed to be around US$2.2billion in 2016H2 (plus a similar amount from domestically held wealth), and US$1.2bn in 2017H1 (again, with a similar amount from domestic wealth).

**Looking forward, public debt issuance and growing FDI will finance the current account over the medium term**. The government is expected to rely extensively on external debt issuance to finance its fiscal deficit. Net external federal government bond issuance will average around US$17 billion per year over 2017–21, in addition to around US$5 billion a year from IFIs. Such large-scale issuance will have a crowding out effect on private sector net borrowing. Similarly, the appreciating exchange rate will create a disincentive for net private inflows. FDI is expected to increase gradually from around 1.8 percent of GDP (accruals basis) in 2015 to about 3 percent in 2021, as foreign investors finance an increasingly large proportion of domestic investment and spending.

## C. FX Intervention and Reserves

**Following the 2001/2 crisis, a shift to significant current account surpluses due to the sharp 50 percent depreciation of the real exchange rate allowed the authorities to amass significant reserves**. Gross international reserves peaked in 2010 at US$52 billion (9-months import cover). These purchases helped maintain a competitive exchange rate, and provided buffers to withstand temporary shocks.

**Gross International Reserves**
(Billions of U.S. dollars)

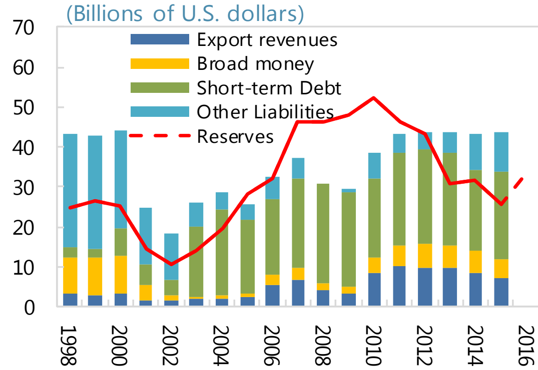



Sources: INDEC and Fund staff calculations.

**Since 2010, external imbalances grew, and this was reflected in a steady decline of reserve coverage**. Since 2010, the FX reserves were used to service foreign currency denominated federal government debt, with an overall cost of US$55 billion. Reserves were also used to finance private capital outflows and the growing CA deficit. By end-2015, gross reserves were US$25.6 billion (58 percent of the IMF's reserve adequacy metric, with capital controls), while net reserves (gross reserve currency assets minus short-term FX obligations) declined to around zero.

**However, even this reserve drawdown was insufficient to meet the balance of payments pressures, and the central bank intervened through selling significant amounts of foreign exchange futures**. Throughout 2015, the central bank confronted devaluation expectations by building a net short position in foreign exchange futures in the local market (that settle in pesos) that peaked in December at US$17.4 billion. The heavy intervention in the domestic futures market, combined with capital controls that prevented full arbitrage, caused a substantial gap between rates in the local and offshore markets. This led to losses totaling AR$53.7 billion on the central bank's balance sheet (once the FX controls were lifted, the exchange rate corrected, and the contracts matured).

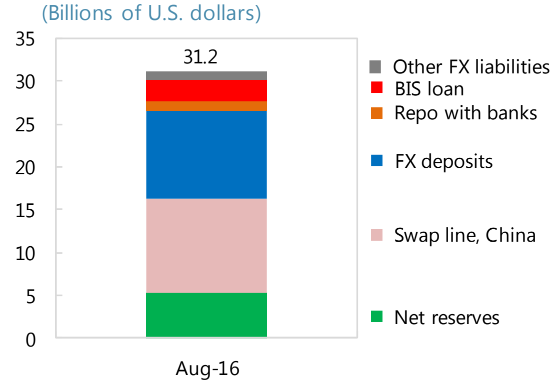
**ARA Metric Decomposition**
(Billions of U.S. dollars)




Sources: BCRA and Fund staff calculations and estimates.

**Since the floating and unification of the exchange rate in December 2015, there has been relatively little FX intervention, and the central bank has generally allowed the exchange rate to adjust with market forces**. The central bank did sell US$0.7 billion in late February to contain an ongoing depreciation of the peso but, since then, has allowed the exchange rate to be determined by market forces. As of end-August, gross reserves were US$31.2 billion amounting to 5.4 months of import cover or 71 percent of the IMF's reserve adequacy metric. A large part of the reserves (US$11 billion) is from a renminbi swap line with China. In addition, the central bank's FX assets include around US$11 billion of reserve requirements for FX bank deposits. Other short-term FX liabilities include a US$2.5 billion loan from the BIS and a US$1 billion a repo with foreign banks.

**International Reserves**
(Billions of U.S. dollars)




Sources: BCRA and Fund staff calculations.

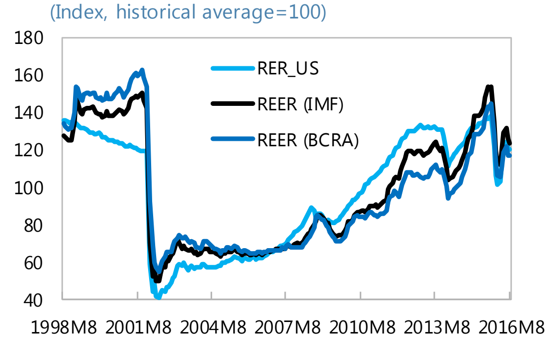
**By end-2016, reserves are expected to grow by a further US$2.2 billion, mainly as a result of resident inflows under the tax amnesty program**. While the regular net issuance of the provincial and federal government for the remainder of the year will be around zero, the tax amnesty is expected to draw in around US$4.5 billion in 2016 (includes tax payments and investments in bonds/investment fund, from both domestic and external sources). This will help the government build additional reserves of around US$2.2 billion, leaving end-2016 at US$33.3 billion (5.7 months import cover).

**Reserves will increase substantially over the coming years funded by large-scale public debt issuance**. The significant net public debt issuance is likely to help build foreign exchange reserves to around US$67 billion, or 8.7 months import cover with an assumption that the BCRA will purchase these proceeds from the FX market. The pace of reserve accumulation envisaged in the baseline would mitigate the pressure on the REER and provide important buffers for temporary external shocks.

## D. Real Exchange Rate

**Argentina's REER has appreciated significantly in recent years**. After the sharp devaluation in 2001 Argentina's REER began a steady appreciation trajectory that accelerated over the last few years despite a one-off correction in 2014. By November 2015, the REER-CPI had doubled compared to its end-2007 level. The bilateral real exchange with Brazil, Argentina major trading partner, followed a similar trend, with the ULC-based bilateral RER up 75 percent by end-2015 from its end-2007 level (reflecting the greater increase in unit labor costs in Argentina).

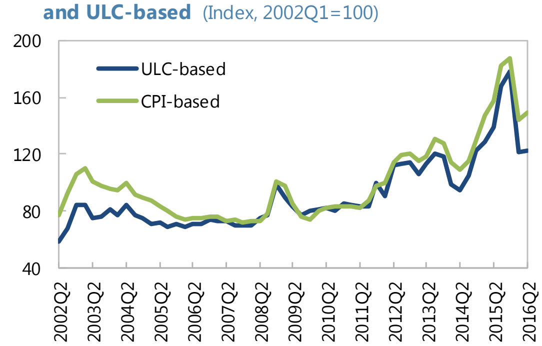
**Multilateral and Bilateral CPI-based Real Exchange Rates**
(Index, historical average=100)




Sources: Haver Analytics, BCRA, and Fund staff estimates.

**The stronger real value of the peso may have hindered external competiveness**. Since 2009, Argentina's share of world export markets has steadily declined, as commodity prices have fallen and non-price competitiveness has weakened. However, this broad trend masks heterogeneity between products. The loss of market shares was greatest for Argentina's main primary products (cereals, soybeans) and energy products, also reflecting high export taxes, export restrictions, and domestic policies of regulated prices and subsidies that discouraged investment and activity in these sectors (see Selected Issues Paper, Chapter 6).

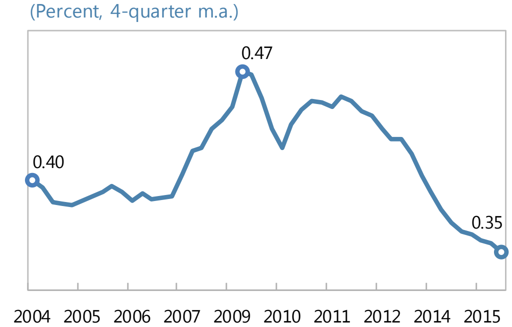
**Bilateral Real Exchange Rate with Brazil, CPI- and ULC-based** (Index, 2002Q1=100)




Sources: Haver Analytics, BCRA, and Fund staff estimates.

**The removal of most FX controls in mid-December 2015 resulted in an immediate 40 percent devaluation of the peso**. However, since March 2016, debt-creating portfolio inflows (as the economy re-leveraged through external financial markets) have sustained the nominal exchange rate within a narrow range. At the same time, the surge in domestic wage

**Argentina's Export Share in World Exports**
(Percent, 4-quarter m.a.)




Sources: IMF Direction of Trade Statistics and Fund staff calculations.

and price inflation contributed to a large real appreciation. As a result, as of end-August 2016 Argentina's REER was about 10 percent above its early 2016 level in late December.

**Exchange Rate Assessment Tools**

(Percent of GDP unless otherwise indicated)

| | Level 2016 | 'Norms' | CA gap | REER gap (percent) |
|---|---|---|---|---|
| | | *ES approach* | | |
| Cyclically-adjusted CA | -2.7 | -0.8 | -2.0 | 15.0 |
| | | *EBA-lite* | | |
| Cyclically-adjusted CA | -2.7 | -1.1 | -1.6 | 12.3 |

Source: Fund staff estimates.

**While there is significant uncertainty about any estimated range, the REER is judged to be 10–15 percent overvalued**. The EBA-lite CA model suggests an overvaluation of about 12 percent (using the estimated CA gap of about -1.6 percent of GDP and an elasticity of the CA to REER of -0.13). Using the CA gap from the ES approach and the same elasticity yields a similar estimate. Measures of Purchasing Power Parities (PPP) also suggest that the peso is overvalued. Indices by PriceStats and World Economics, for example, suggest an overvaluation of between 5–20 percent in August.

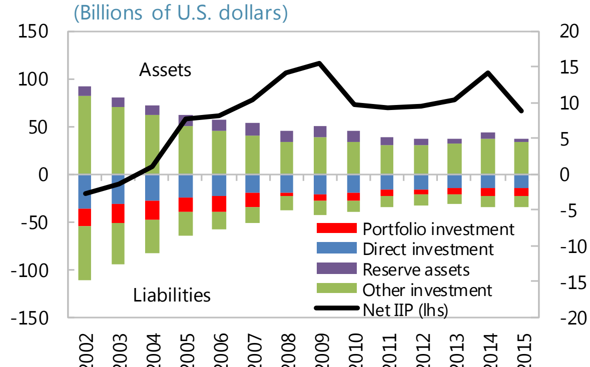
## E. External Balance Sheet

**More than a decade of financial isolation means that Argentina's gross external assets and liabilities are amongst the smallest among EMs**. The net positive IIP position of 9 percent of GDP in 2015 is unusual for an emerging market. The majority of external assets are in the form of debt ('other investment'), while slightly less than half of liabilities are in the form of FDI. External debt is low (see Annex Figure 1 and Annex Table 2), of which over 50 percent is held by the general government and central bank, while the banking sector has borrowed very little from abroad.

**The balance sheet is robust to a nominal depreciation**. Argentina's external assets and liabilities are predominately denominated in foreign currency, and, while individual entities in the economy may have a net open FX position, there is no large net exposure of balance sheets to a depreciation. There may be currency mismatches within particular sectors or agents within the economy, so exchange rate shocks could still cause balance sheet problems that affect the real economy (see Selected Issues Paper, Chapter 7).

**International Investment Position**

(Billions of U.S. dollars)




Sources: INDEC and Fund staff calculations.

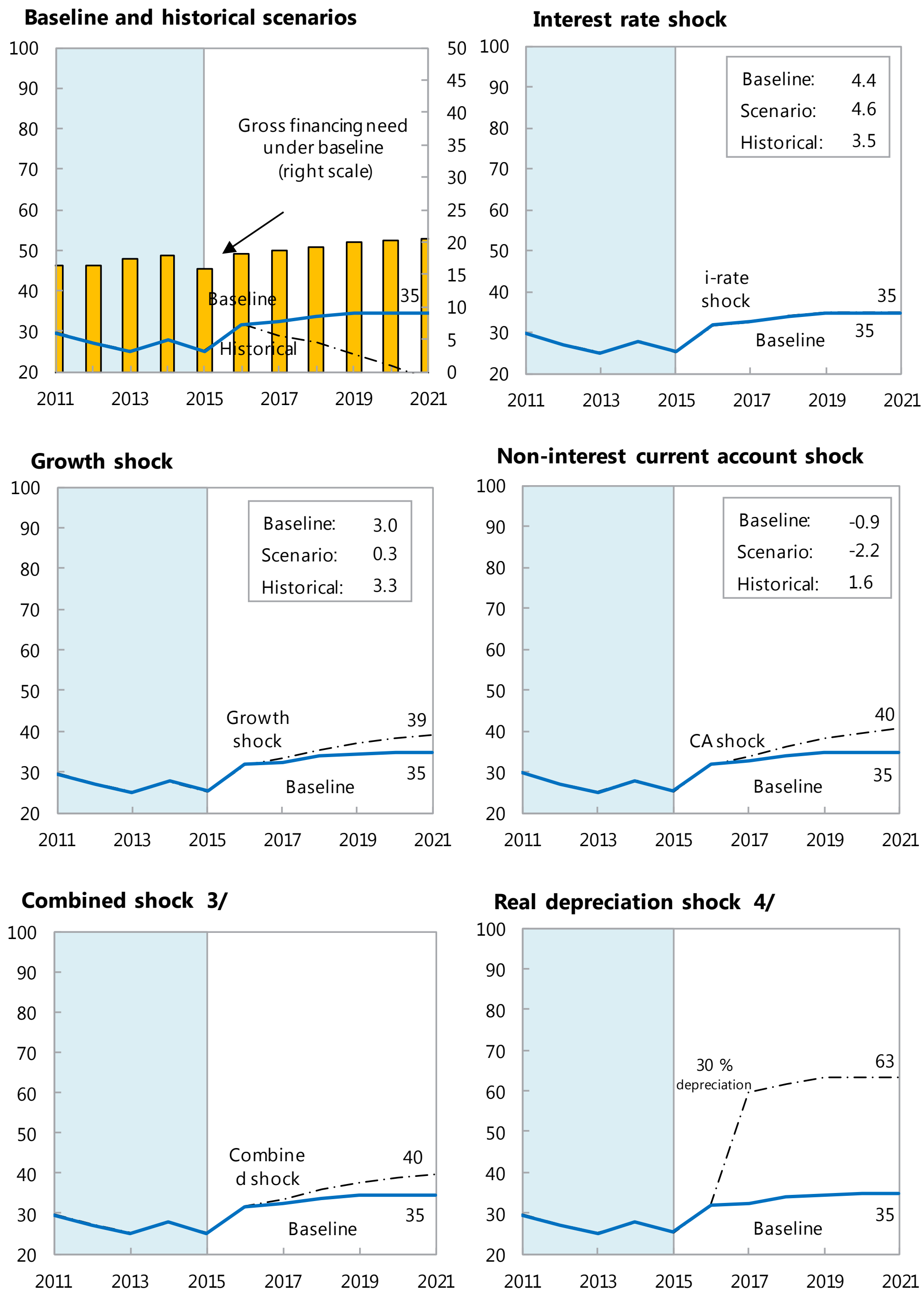
**Given that 30 percent of foreign liabilities (US$41 billion) are in the form of short-term debt obligations, this creates an important rollover risk**. There appears to be a concentration of short-term foreign currency debt in the non-bank private sector. This borrowing is concentrated in the petroleum and industrial manufacturing industries and predominately appears to be associated with credit lines for import financing. While a sudden stop in such trade financing will have important implications for the ability of business to conduct trade, this may not have the same balance sheet spillovers as a discontinuation of other forms of debt obligations, such as working capital.

**By 2021, the external balance sheet is expected to switch from a net asset to net liability position**. Gross assets and liabilities are likely to grow in coming years as a more open capital account allows greater foreign investment in Argentina and greater portfolio diversification by residents. In coming years, this expansion is driven primarily by public sector borrowing, which will rely on external financing to fund much of its deficit and rollover needs. However, as fiscal consolidation sets in and crowding out effects diminish, the private corporate sector will become increasingly exposed to international capital markets through borrowing.

| Annex Table 1. Summary of Foreign Exchange Controls | |
|---|---|
| **Selected Prior Controls** | **Current status** |
| Some sectors were given a monthly quota of dollars to pay for their imports (Sep 2014) | Control eliminated |
| Informal prior authorization from the central bank required to make import payments (Dec 2011, tightened Jun 2013, Oct 2013, Sep 2014, Feb 2015, Oct 2015, Nov 2015) | Control eliminated |
| Informal prior authorization and limits imposed by the central bank on dividend payments | Control eliminated |
| Informal requirement that importers match the volume of imports with similar amount of FX inflows (exports or FDI) (Feb 2014) | Control eliminated |
| Importers required to provide detailed information on owners, employees, investment plans, etc. to get their imports approved (Nov 2014) | Control eliminated |
| Temporary blockade on all import payments (Feb 2015) | Control eliminated |
| Commercial banks needed to provide detailed information on transactions and obtain central bank approval before issuing letters of credit to importers (Feb 2015) | Control eliminated |
| Ban on banks lending in pesos to exporters, designed to force them to get dollar financing and thus increase FX supply (Nov 2013) | Control eliminated |
| Prior authorization from the tax agency to purchase dollars for savings ('dólar ahorro') (Oct 2011, tightened Jul 2012, partially eased Jan 2014) | Control eliminated |
| FX purchases for tourism subject to controls and required an authorization from the federal tax agency (with a 35 percent tax surcharge since end-2013 that also covers the use of credit and debit cards abroad) (May 2012, tightened Aug 2012, Sep 2012, Mar 2013, May 2013, Dec 2013) | Control eliminated |
| Web-based purchases abroad require prior authorization and are limited to two transactions of up to $25 per year. (Jan 2014) | Control eliminated |
| Cap on banks' net FX position, including holdings of cash and dollar bonds, and the net FX futures position (tightened Feb 2014, Sep 2014, Nov 2015) | Control eased (maximum limit for banks' net FX position raised to 15% of computed capital). |
| Restriction on capital inflows: mandatory 365-day unremunerated deposit equivalent to 30% of capital inflow (2005) | Control eliminated (deposit amount reduced to 0%) |
| Restriction on FX transfers (inflows and outflows) between local and foreign bank accounts. | Control eliminated |

## Annex Figure 1. Argentina: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)




1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2016.

## Annex Table 2. Argentina: External Debt Sustainability Framework, 2011–21

(In percent of GDP, unless otherwise indicated)

| | Actual | | | | | | | Projections | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2011 | 2012 | 2013 | 2014 | 2015 | | | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | **Debt-stabilizing non-interest current account 6/** |
| **Baseline: External debt** | 29.6 | 27.1 | 25.0 | 27.8 | 25.2 | | | **31.7** | **32.5** | **33.8** | **34.5** | **34.6** | **34.6** | **-3.4** |
| Change in external debt | -4.6 | -2.5 | -2.1 | 2.7 | -2.6 | | | 6.6 | 0.8 | 1.3 | 0.8 | 0.1 | 0.0 | |
| Identified external debt-creating flows (4+8+9) | -7.6 | -4.9 | -1.0 | 2.9 | -2.2 | | | 0.3 | -0.6 | -0.7 | -0.6 | -0.7 | -0.6 | |
| Current account deficit, excluding interest payments | -0.1 | -0.6 | 1.1 | 0.5 | 1.7 | | | 0.5 | 0.7 | 0.8 | 0.9 | 1.0 | 1.2 | |
| Deficit in balance of goods and services | -5.2 | -5.2 | -3.2 | -3.5 | -2.2 | | | -3.4 | -2.4 | -2.2 | -1.8 | -1.5 | -1.1 | |
| Exports | 18.7 | 16.4 | 14.8 | 14.6 | 11.2 | | | 13.0 | 12.0 | 11.2 | 10.7 | 10.4 | 9.9 | |
| Imports | 13.4 | 11.2 | 11.7 | 11.1 | 9.1 | | | 9.7 | 9.5 | 9.1 | 8.9 | 8.8 | 8.8 | |
| Net non-debt creating capital inflows (negative) | -1.7 | -2.4 | -1.5 | -0.6 | -1.8 | | | -1.8 | -1.9 | -1.9 | -1.9 | -2.0 | -2.0 | |
| Automatic debt dynamics 1/ | -5.8 | -1.8 | -0.6 | 3.1 | -2.1 | | | 1.6 | 0.6 | 0.5 | 0.4 | 0.3 | 0.2 | |
| Contribution from nominal interest rate | 0.9 | 0.9 | 0.8 | 1.0 | 0.8 | | | 1.1 | 1.4 | 1.3 | 1.3 | 1.3 | 1.3 | |
| Contribution from real GDP growth | -1.7 | 0.3 | -0.6 | 0.7 | -0.6 | | | 0.5 | -0.8 | -0.8 | -0.9 | -1.0 | -1.0 | |
| Contribution from price and exchange rate changes 2/ | -5.0 | -3.0 | -0.8 | 1.4 | -2.3 | | | ... | ... | ... | ... | ... | ... | |
| Residual, incl. change in gross foreign assets (2-3) 3/ | 3.0 | 2.4 | -1.1 | -0.2 | -0.4 | | | 6.3 | 1.4 | 1.9 | 1.4 | 0.7 | 0.5 | |
| External debt-to-exports ratio (in percent) | 158.8 | 165.2 | 168.7 | 190.1 | 223.9 | | | 243.1 | 271.2 | 300.3 | 322.7 | 333.9 | 348.5 | |
| **Gross external financing need (in billions of US dollars) 4/** | 86.2 | 95.3 | 106.4 | 100.4 | 99.8 | | | 98.9 | 111.3 | 124.5 | 141.5 | 157.0 | 172.7 | |
| in percent of GDP | 16.3 | 16.4 | 17.4 | 17.8 | 15.8 | 10-Year | 10-Year | 18.2 | 18.7 | 19.1 | 20.0 | 20.3 | 20.5 | |
| **Scenario with key variables at their historical averages 5/** | | | | | | | | **31.7** | **29.0** | **27.1** | **24.5** | **21.5** | **18.3** | **-3.3** |
| **Key Macroeconomic Assumptions Underlying Baseline** | | | | | | Historical Average | Standard Deviation | | | | | | | |
| Real GDP growth (in percent) | 6.0 | -1.0 | 2.4 | -2.5 | 2.5 | 3.3 | 5.3 | -1.8 | 2.7 | 2.8 | 2.9 | 3.1 | 3.3 | |
| GDP deflator in US dollars (change in percent) | 17.3 | 11.1 | 3.0 | -5.4 | 9.1 | 9.1 | 8.5 | -12.2 | 6.4 | 6.7 | 5.8 | 5.7 | 5.3 | |
| Nominal external interest rate (in percent) | 3.4 | 3.2 | 3.2 | 3.5 | 3.3 | 3.5 | 0.4 | 3.9 | 4.9 | 4.5 | 4.3 | 4.1 | 4.0 | |
| Growth of exports (US dollar terms, in percent) | 20.4 | -3.3 | -4.7 | -9.3 | -13.9 | 5.4 | 17.0 | 0.1 | 0.4 | 2.9 | 3.6 | 5.6 | 4.1 | |
| Growth of imports (US dollar terms, in percent) | 30.7 | -8.1 | 9.6 | -12.4 | -8.4 | 10.3 | 24.7 | -8.2 | 8.0 | 4.0 | 7.1 | 8.2 | 8.0 | |
| Current account balance, excluding interest payments | 0.1 | 0.6 | -1.1 | -0.5 | -1.7 | 1.6 | 2.6 | -0.5 | -0.7 | -0.8 | -0.9 | -1.0 | -1.2 | |
| Net non-debt creating capital inflows | 1.7 | 2.4 | 1.5 | 0.6 | 1.8 | 1.8 | 0.6 | 1.8 | 1.9 | 1.9 | 1.9 | 2.0 | 2.0 | |

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

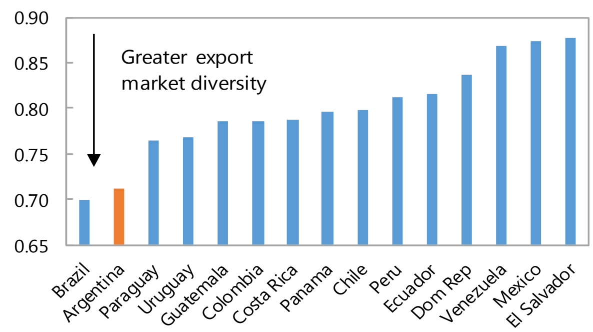
# Annex II. Potential Cross Border Spillovers

*Argentina is a relatively closed economy, with modest trade and small financial linkages with the rest of the world. A significant decline in growth in Brazil, China or the U.S. would, however, have a material impact on exports and growth performance. Food commodity price shocks are also a source of vulnerability. Argentina's relative isolation from international capital markets, its positive net IIP position, and the absence of large maturity and currency external balance sheet mismatches suggest that vulnerabilities from external financial shocks are limited at present. A few regional economies are highly dependent on imports from Argentina, in particular Bolivia and Trinidad and Tobago.*

## A. Inward Spillovers

**International trade makes up a small component of GDP, and exports are relatively well diversified in terms of market destination**. Argentina has the smallest ratio of exports to GDP of all Latin American EMs—12 percent of GDP in 2015, compared to an average of 24 percent across the region. This follows a steady decline in importance of trade in the economy since 2004, when the ratio was 21 percent. Compared to its regional peers, Argentina is fairly well diversified in terms of export market destinations,[1] although about 40 percent of its exports still go to its 5 largest export markets (average of 2014–15)—Brazil (19 percent), China (7½ percent), the U.S. (6 percent), Chile (4 percent), and India (3 percent). Lower activity in these economies will have an impact on Argentina's exports and growth.

**Export Market Diversification**
("Export Gini coefficient")




Sources: IMF, Direction of Trade Statistics and staff calculations.

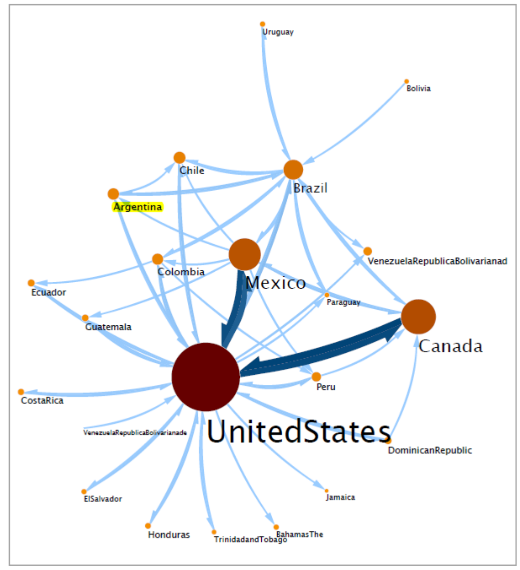
**Cluster analysis suggests that Argentina is connected to the rest of world trade through the United States**. Examining the network characteristics[2] of international bilateral trade links identifies three major global trade 'nodes'—the U.S., China, and Germany. Argentina forms part of the U.S. trade cluster. This suggests that second-round effects from U.S. activity are also important—for example, a decline in U.S. growth will also weaken activity in countries such as Brazil, Chile, and Mexico, which will then impact trade with Argentina. The U.S. economy is also likely to be the main conduit for shocks originating in the rest of the world.

[1] As measured by an "export Gini coefficient", which measures the share of exports by destination market compared to a hypothetical scenario where exports are shared evenly across all possible markets. If exports were spread evenly across all countries ('full diversification'), then the coefficient would equal zero. If all exports went to one country ('no diversification'), the coefficient would equal one.

[2] This analysis uses Hierarchical Network Navigator application on the MapEquation website. The tool uses an algorithm developed by Rosvall and Bergstrom (2011)—*Multilevel Compression of Random Walks on Networks Reveals Hierarchical Organization in Large Integrated Systems*.

**Argentina's export concentration in agricultural commodities exposes it to commodity price shocks**. As of 2015, over 60 percent of exports is constituted by agricultural commodities, comprising both primary products and agriculture related manufacturing products (vehicle exports make up a further 10 percent of the total). The degree of diversification has declined since 2005 largely driven by the growing specialization in soy and cereal products. This leaves Argentina vulnerable to shocks to global agricultural prices. For example, a 10 percent decline in global agricultural commodity prices would lead to around a 2 percent decline in overall export values (direct effects only).

**Network map**



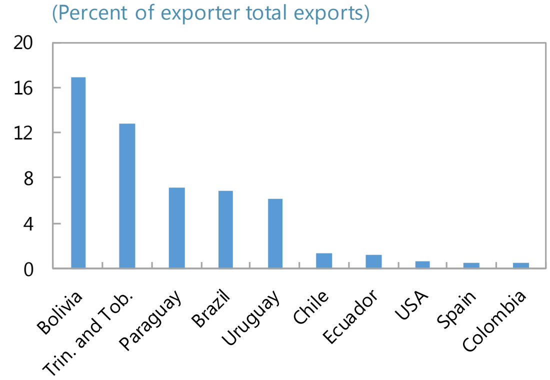

Sources: IMF, World Economic Outlook database, Mapequation website and Fund staff calculations.

**Relative isolation from international capital markets shields Argentina from financial spillovers**. As discussed in detail in Chapter 7 of the Selected Issues Paper, Argentina has relatively few links to international capital markets, and its positive net IIP position, and the absence of significant currency or maturity mismatches imply that risks from external financial stocks are contained. While 95 percent of portfolio investments are reported to be from the U.S. (CPIS database), the ultimate holders of these liabilities are likely to be more broadly globally diffused.

## B. Outward Spillovers

**A number of regional economies are reliant on Argentina as an export market**. Exports to Argentina from Bolivia and Trinidad and Tobago (mainly liquefied natural gas) account for 17 percent and 13 percent of their total exports, respectively. This suggests that potential outward trade spillovers to these countries could be large. Paraguay, Brazil, and Uruguay supply around 6 percent of their exports to Argentina, suggesting a modest degree of interconnectedness, but not enough to pose a major vulnerability to these economies.

**10 Largest Exporters to Argentina**
(Percent of exporter total exports)




Sources: Direction of Trade Statistics and Fund staff calculations.

**Argentina is unlikely to be a major source of regional financial spillover risk**. The crisis in the early 2000s generated regional financial spillovers, especially in Uruguay given its reliance on Argentine resident deposits in the domestic banking sector. These regional financial links are much smaller today, with most financial assets concentrated in global financial centers. Over 80 percent of Argentine portfolio assets (as reported by other economies) are concentrated in the U.S., Luxembourg, Italy, and the United Kingdom. Only 2 percent are reported to be held in Brazil, with virtually no holdings in the rest of the region.

INTERNATIONAL MONETARY FUND

# ARGENTINA

October 19, 2016

## STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS


Prepared By | The Western Hemisphere Department (In consultation with other departments)


## CONTENTS

# PUBLIC DEBT SUSTAINABILITY ANALYSIS

*Federal government gross debt is 52 percent of GDP and is expected to decline slightly in the medium term, as the improvement in the primary balance is largely offset by higher interest payments. Risks to solvency are modest but there are vulnerabilities from the high share of external debt and sizable gross public gross financing needs. In particular, given that more than two-thirds of public debt is foreign currency denominated, the headline debt-to-GDP ratio is understated by the current overvaluation of the exchange rate. Provincial debt was at around 5 percent of GDP in 2015, but most of provincial debt is concentrated in few provinces with large deficits.*

## A. Background

At end-2015, the federal government gross debt stood at about AR$3,000 billion, amounting to 52.1 percent of GDP.[1] Reported financial assets of the federal government amount to AR$22 billion, implying a net debt measure that is very close to the gross level.

- *Currency composition*. 72 percent of federal debt is either denominated in foreign currency or is FX-linked (mostly U.S. dollars). About 20 percent this FX debt is owed to the official sector (the IADB, the World Bank, and the Paris Club creditors) with virtually all of the remainder in the form of FX bonds. Around one-third of peso-denominated debt are bonds linked to inflation or the U.S. dollar (with contractual obligations settled in pesos).

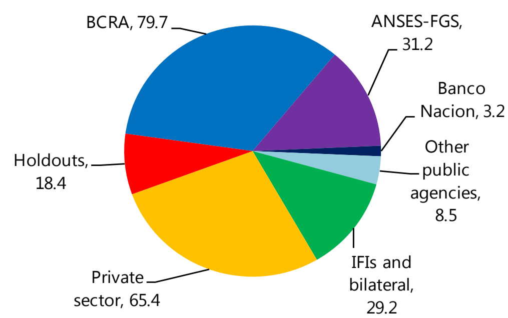
**Debt Composition, End of 2015**

| | Peso, billion | Percent of GDP | Percent of total |
|---|---|---|---|
| Total public debt | 3,046 | 52.1 | 100.0 |
| FX denominated | 2,108 | 36.1 | 69.2 |
| Peso denominated | 939 | 16.1 | 30.8 |
| *Unindexed* | *652* | *11.2* | *21.4* |
| *Inflation indexed* | *203* | *3.5* | *6.7* |
| *FX indexed* | *85* | *1.5* | *2.8* |

Sources: Ministerio de Hacienda and Fund staff calculations.

- *Holdings*. It is estimated that 35 percent of total debt was held by external creditors in 2015; and three-quarters of the debt were issued under the Argentine law. About 60 percent of federal debt (equivalent to 21 percent of GDP) is held by intra-public sector entities, predominantly the central bank and social security fund (ANSES). The majority of intra-public sector debt is either non-interest bearing or earns interest that is netted out from the overall balance (as in the case of ANSES). This significantly reduces the headline effective interest rate paid by the federal government.

**Federal Government Gross Debt by Creditor**
(Billions of U.S. dollars, end-March, 2016)




Sources: Ministerio de Hacienda, BCRA, and ANSES.

[1] This excludes the balance sheets of the provinces, ANSES, and the BCRA. It includes US$11.5 billion (1.8 percent of GDP) of 'untendered debt', which was unresolved from the 2001 default.

- *Maturity*. The average residual maturity of debt is 9.1 years, split between long maturity FX debt (10.5 years) and short maturity peso debt (4 years).[2] This high average maturity partly reflects the long maturity debt issued in the 2005 and 2010 debt exchanges.

**Federal Government Debt Service Schedule**
(Percent of GDP)

| | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|
| **Total** | **7.6** | **9.1** | **7.3** | **6.5** | **6.0** | **5.0** | **6.4** |
| FX denominated | 4.9 | 6.6 | 3.6 | 3.0 | 3.2 | 2.4 | 3.9 |
| *Amortization* | *4.1* | *5.3* | *2.4* | *1.6* | *1.7* | *0.9* | *2.4* |
| *Interest* | *0.8* | *1.3* | *1.3* | *1.4* | *1.5* | *1.5* | *1.5* |
| Peso denominated | 2.7 | 2.5 | 3.7 | 3.5 | 2.8 | 2.6 | 2.5 |
| *Amortization* | *1.5* | *1.4* | *2.4* | *2.1* | *1.7* | *1.6* | *1.6* |
| *Interest* | *1.3* | *1.1* | *1.3* | *1.4* | *1.2* | *1.0* | *0.9* |

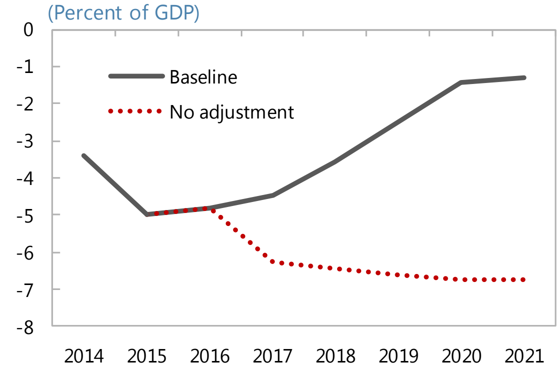
Sources: Ministerio de Hacienda and Fund staff estimates.

## B. Baseline Scenario

Staff's baseline outlook is as follows:

- *Primary deficit.* Staff's baseline assumes current policies for 2016 and 2017. The expected expansion of spending on pensions, together with the increased co-participation transfers to provinces, will largely be offset by a reduction in subsidies and discretionary transfers to provinces. The federal government primary deficit is expected to decrease to about 4.5 percent of GDP in 2017 from 4.8 percent in the previous year. From 2018 onwards, staff's baseline assumes a fiscal consolidation of about ¾–1 percent of GDP per year, to a primary deficit of 1.3 percent of GDP in 2021. This pace of fiscal consolidation is consistent with staff's estimates of the amount of new financing that will realistically be available over the medium term (see Table 1) and with a slightly slower pace of medium-term fiscal rebalancing than announced by the authorities earlier in 2016. Finally, the pace of fiscal consolidation is within the inter-quartile range of past consolidation episodes in other countries. For these reasons, it is assessed to be realistic.

**Federal Government Primary Balance**
(Percent of GDP)




Sources: Ministerio de Hacienda and Fund staff estimates.

- *Debt servicing costs*. The high levels of inflation experienced in recent years, together with a high proportion of non-interest bearing debt financing, have generated significantly negative real

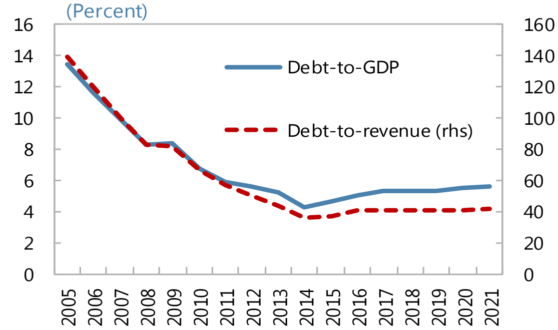
[2] CPI-indexed debt makes up 10 percent of the local currency debt stock and has an average residual maturity of 22.4 years. Excluding this, the average residual maturity of local currency debt is 2 years.

effective interest rates. This high inflation is partially offset by the valuation effect on foreign currency-denominated debt from the nominal exchange rate depreciation.

## Box 1. Fiscal Outlook for Provinces

Thanks to the federal-for-provincial debt swap initiated in 2004, provincial debt steadily declined during the past 10 years and reached 4.6 percent of national GDP in 2015, or 38 percent of provincial tax revenues (including the portion of the taxes shared with the national government). A third of provincial debt is held by the federal government. At the same time, the combined primary deficit was below 0.1 percent of national GDP, on average, during 2005–14, but it picked up to 0.4 percent in 2015, on account of an increase in the wage bill and current transfers.

**Provincial Debt Ratios**
(Percent)

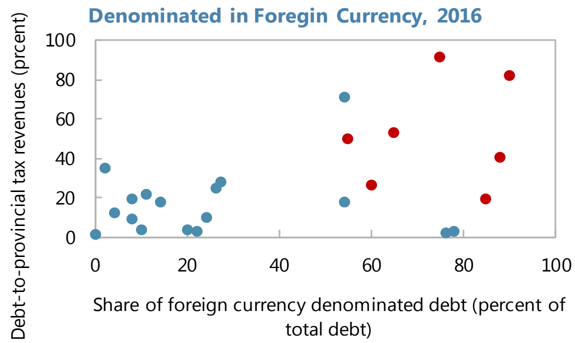



Sources: Ministerio de Hacienda and Fund staff estimates.

Under the baseline scenario, the provincial primary deficit is expected to increase to 0.7 percent of national GDP in 2016, driven by higher wages and capital spending, and then decline gradually to 0.5 percent by 2021, mainly thanks to the devolution of shared revenues that were previously earmarked to ANSES, that is assumed to more than offset lower discretionary transfers from the federal government. Debt is expected to stabilize at 5.6 percent of national GDP in 2021. Although low, these aggregate numbers mask large heterogeneity and vulnerabilities:

- *Most of provincial debt is concentrated in a few provinces with large deficits.* The province and the autonomous city of Buenos Aires (which account for about half of Argentina's population and GDP) contribute to over half of total provincial debt, with another 20 percent concentrated in other five provinces (Cordoba, Chubut, Mendoza, Neuquen, and Santa Cruz).

**Debt to Provincial Revenue and Share of Debt Denominated in Foregin Currency, 2016**




Sources: Ministerio de Hacienda and Fund staff estimates.
Note: Red dots indicate the provinces that have been issuing debt denominated in foreign currency since January 2016.

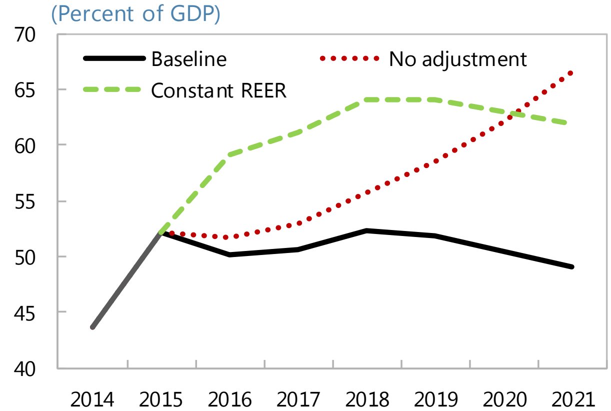
- *Over 60 percent of provincial debt is denominated in foreign currency.* Since January 2016, the seven provinces mentioned above (those with the largest debt, and the greatest share of FX-denominated debt) have accessed international markets, issuing FX debt for a total of US$5.6 billion. This exposes them to exchange rate risk. For example, a one step 50 percent depreciation in 2017 would increase debt to 47 percent of provincial revenues (from 38 under the baseline), the equivalent of 6.3 percent of national GDP, by 2021.

Under staff's baseline, the government will become less reliant on central bank funding and increasingly more dependent on external market financing in foreign currency (the share of FX debt and FX-linked will increase from 69 to 80 percent of total debt between 2015 and 2021).

Along with the decline in inflation, this will push up real effective interest rates. As a result, interest spending will increase from 2.1 percent of GDP in 2015 to 2.5 percent of GDP by 2021.

- *Debt.* Debt is expected to decline slightly over staff's forecast horizon, from 52 percent of GDP in 2015 to 47½ percent in 2021, well below the 'high risk' summary indicator for emerging markets (70 percent of GDP). In the absence of any fiscal consolidation after 2016, the public debt ratio would reach about 67 percent of GDP by 2021. In a scenario where the current estimated REER overvaluation (between 10 and 15 percent) corrects through a nominal depreciation in 2016, and absent any further real appreciation in the following years, gross federal debt would reach 60 percent of GDP in 2021.

**Federal Government Gross Debt**
(Percent of GDP)




Sources: Ministerio de Hacienda and Fund staff estimates.

- *Gross financing needs.* The large overall fiscal deficit and amortization profiles in 2016–17 will keep gross financing needs (GFNs) elevated at above 10 percent of GDP. In 2016, GFNs will peak at 13.2 percent of GDP, slightly below the 'high risk' summary indicator. Going forward, fiscal consolidation and lower amortization needs imply a decline of GFNs to 6–7 percent of GDP by the end of the projection horizon.

## C. Shocks and Stress Tests

- *Solvency risks are contained.* The relatively low level of debt and the modest downward trajectory suggest that the risk of a solvency crisis for the federal government is modest. Shocks to the primary balance and interest rates are unlikely to cause debt to increase significantly. However, the high and rising share of FX-denominated debt poses risks, especially given that the exchange rate is currently viewed as overvalued (see above). In addition, a shock to real GDP growth (-1 percent in 2017 and 2018) would cause debt-to-GDP ratio to jump to 66 percent in 2018. Finally, a combined macroeconomic shock could be very detrimental and push debt just below 90 percent of GDP by 2018.

- *Liquidity risks are higher.* The relatively high level of GFNs through the medium term increases vulnerabilities to a liquidity crisis. A shock to real growth—with knock-on impacts to the primary balance and credit spreads (each 1 percent deviation of the primary balance would increase spreads by 25 basis points, for a total increase of 125 basis points in 2018)—would push GFNs to 15 percent of GDP. A shock to exchange rate would cause a similar spike, and a combined shock would push GFNs as high as 19 percent of GDP.

- *Contingent liabilities could also increase the debt level*. Under current policies, contingent liabilities from the increase in pension spending over the long run are estimated to be 40 percent of GDP in net present value term.

**Mitigating factors**. Rollover risks are mitigated by intra-government cross holdings. The high share of debt held by other public entities reduces the risk of a liquidity crisis. In times of stress, the federal government will likely be able to rely on other public bodies (notably ANSES and the BCRA) to rollover debt coming due and even purchase new issuances. While this can significantly reduce rollover risks for the federal government, it would constrain the behavior of these public entities, preventing them from diversifying risk and pursuing better yielding investment strategies, apart from crowding out private sector credit. Importantly, these intra-government debt holdings do not reduce solvency risks and should therefore not be 'netted out' of the headline debt stock. The federal government is obliged to repay these claims in full, and a failure to do so would cause significant problems on the balance sheets of these public entities.

## Table 1. Argentina: Federal Government—Funding Envelope and Sources

| | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|
| (Billions of U.S. dollars, unless otherwise indicated) | | | | | | | |
| **Baseline (fiscal adjustment after 2017)** | | | | | | | |
| Primary balance excl. BCRA+ANSES | -31.5 | -26.1 | -26.7 | -23.2 | -17.7 | -11.0 | -10.8 |
| *Percent of GDP* | *-5.0* | *-4.8* | *-4.5* | *-3.6* | *-2.5* | *-1.4* | *-1.3* |
| Interest (net of ANSES) | 7.4 | 9.1 | 10.8 | 13.3 | 13.5 | 13.9 | 14.4 |
| **Overall balance excl. BCRA** | **-38.9** | **-35.1** | **-37.5** | **-36.5** | **-31.3** | **-24.9** | **-25.2** |
| *Percent of GDP* | *-6.2* | *-6.5* | *-6.3* | *-5.6* | *-4.4* | *-3.2* | *-3.0* |
| **Amortization** | **34.9** | **36.3** | **28.2** | **24.0** | **24.1** | **19.3** | **33.2** |
| *Percent of GDP* | *5.5* | *6.7* | *4.7* | *3.7* | *3.4* | *2.5* | *3.9* |
| **Gross financing needs** | **67.4** | **64.3** | **62.5** | **59.5** | **54.9** | **44.3** | **58.6** |
| *Percent of GDP* | *11.7* | *13.2* | *11.0* | *9.3* | *7.8* | *5.7* | *6.9* |
| **Total net new financing** | **38.9** | **35.1** | **37.5** | **36.5** | **31.3** | **24.9** | **25.2** |
| *Percent of GDP* | *6.2* | *6.5* | *6.3* | *5.6* | *4.4* | *3.2* | *3.0* |
| Intra-public sector (excl. Banco Nacion) | 26.0 | 12.6 | 10.6 | 10.1 | 7.2 | 5.5 | 4.3 |
| BCRA | 25.3 | 10.8 | 8.8 | 7.3 | 5.3 | 3.6 | 2.2 |
| Profit transfer | 8.4 | 7.4 | 3.5 | 1.3 | 0.7 | 0.0 | 0.0 |
| Advances | 16.9 | 3.4 | 5.3 | 6.0 | 4.6 | 3.6 | 2.2 |
| ANSES (FGS) | 0.2 | 0.4 | 0.8 | 0.4 | 0.3 | 0.2 | 0.3 |
| Other government agencies | 0.5 | 1.4 | 1.1 | 2.4 | 1.6 | 1.7 | 1.8 |
| Private creditors | 14.9 | 22.8 | 27.2 | 26.7 | 24.3 | 19.5 | 21.2 |
| External creditors 1/ | 1.5 | 11.0 | 18.1 | 23.7 | 21.8 | 19.5 | 19.6 |
| IFIs | 0.2 | 3.9 | 4.5 | 4.5 | 5.5 | 5.2 | 4.7 |
| Paris Club & other official | -0.6 | -2.1 | -2.0 | -2.0 | -1.6 | -0.2 | -0.2 |
| Private bonds | 1.9 | 18.7 | 15.6 | 21.2 | 17.9 | 14.5 | 15.0 |
| Domestic creditors | 13.5 | 11.8 | 9.2 | 3.0 | 2.5 | 0.0 | 1.6 |
| Banking sector | 0.9 | 5.3 | 5.1 | 0.2 | 1.7 | 1.6 | 2.1 |
| Non-bank domestic creditors | 12.6 | 6.5 | 4.1 | 2.8 | 0.8 | -1.7 | -0.5 |
| Other (valuation effects) | -2.1 | -0.3 | -0.3 | -0.3 | -0.2 | -0.1 | -0.2 |
| Memo: Federal gross debt, percent of GDP | 52.1 | 51.8 | 51.1 | 51.2 | 50.0 | 48.4 | 47.5 |
| **No fiscal adjustment after 2017** | | | | | | | |
| Primary balance excl. BCRA+ANSES | -31.5 | -26.1 | -37.4 | -41.9 | -46.9 | -52.2 | -56.5 |
| *Percent of GDP* | *-5.0* | *-4.8* | *-6.3* | *-6.4* | *-6.6* | *-6.7* | *-6.7* |
| Interest (net of ANSES) | 7.4 | 9.1 | 10.8 | 15.0 | 17.7 | 21.5 | 27.7 |
| **Overall balance excl. BCRA** | -38.9 | -35.1 | -48.2 | -56.9 | -64.6 | -73.6 | -84.2 |
| *Percent of GDP* | *-6.2* | *-6.5* | *-8.1* | *-8.7* | *-9.1* | *-9.5* | *-10.0* |
| **Total net new financing** | **38.9** | **35.1** | **48.2** | **56.9** | **64.6** | **73.6** | **84.2** |
| Identified (=baseline) | 38.9 | 35.1 | 37.5 | 36.5 | 31.3 | 24.9 | 25.2 |
| Unidentified | ... | ... | 10.7 | 20.4 | 33.3 | 48.8 | 59.0 |
| Memo: Federal gross debt, percent of GDP | 52.1 | 51.8 | 52.9 | 55.8 | 58.6 | 62.1 | 66.6 |

Source: Fund staff estimates.
1/ Includes repayment to holdout creditors of US$9.5 billion in 2016.

## Figure 1. Argentina: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(In percent of GDP, unless otherwise indicated)

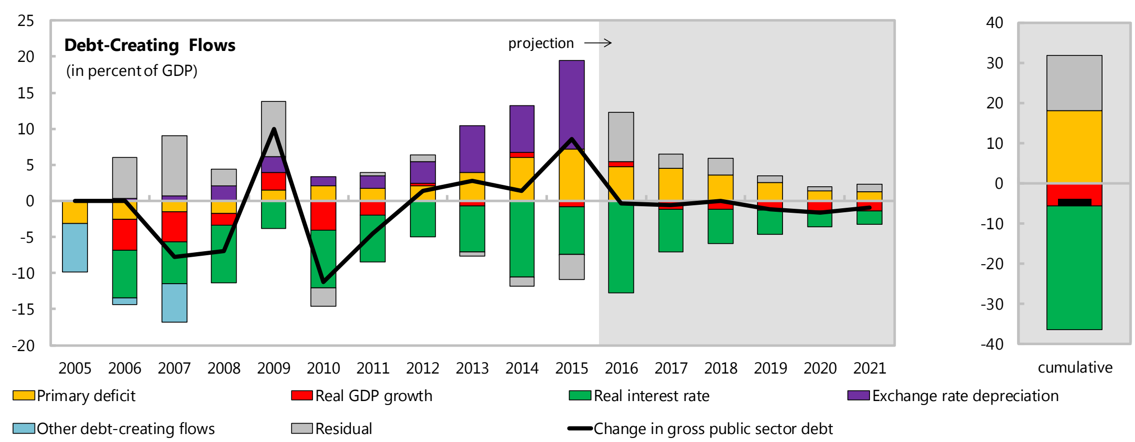
### Debt, Economic and Market Indicators [1/]

| | Actual | | | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2005-2013 [2/] | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
| Nominal gross public debt | 48.5 | 43.6 | 52.1 | 51.8 | 51.1 | 51.2 | 50.0 | 48.4 | 47.5 |
| Public gross financing needs | 9.8 | 9.0 | 12.6 | 13.3 | 11.8 | 10.0 | 8.5 | 6.5 | 7.7 |
| Real GDP growth (in percent) | 4.6 | -2.5 | 2.5 | -1.8 | 2.7 | 2.8 | 2.9 | 3.1 | 3.3 |
| Inflation (GDP deflator, in percent) | 18.7 | 40.3 | 24.5 | 40.6 | 22.6 | 19.4 | 15.3 | 11.5 | 9.6 |
| Nominal GDP growth (in percent) | 24.1 | 36.8 | 27.6 | 37.6 | 26.5 | 22.5 | 18.7 | 15.0 | 13.2 |
| Effective interest rate (in percent) [4/] | 4.3 | 5.0 | 6.1 | 6.2 | 8.6 | 8.4 | 7.9 | 6.8 | 5.7 |

| As of June 01, 2016 | | |
|---|---|---|
| Sovereign Spreads | | |
| EMBIG (bp) 3/ | | 441 |
| 5Y CDS (bp) | | 363 |
| Ratings | Foreign | Local |
| Moody's | B3 | B3 |
| S&Ps | B- | B- |
| Fitch | B | B |

### Contribution to Changes in Public Debt

| | Actual | | | Projections | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2005-2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | cumulative | debt-stabilizing primary balance [9/] |
| Change in gross public sector debt | -2.1 | 1.4 | 8.5 | -0.4 | -0.6 | 0.0 | -1.2 | -1.6 | -0.9 | -4.7 | |
| Identified debt-creating flows | -5.9 | 2.7 | 12.1 | -7.2 | -2.6 | -2.4 | -2.1 | -2.2 | -1.9 | -18.5 | |
| Primary deficit | 0.3 | 6.0 | 7.2 | 4.8 | 4.5 | 3.6 | 2.5 | 1.4 | 1.3 | 18.1 | -0.3 |
| Primary (noninterest) revenue and grants | 23.3 | 23.1 | 25.0 | 25.7 | 25.6 | 25.5 | 25.3 | 25.1 | 25.0 | 152.1 | |
| Primary (noninterest) expenditure | 23.6 | 29.1 | 32.2 | 30.5 | 30.1 | 29.0 | 27.8 | 26.5 | 26.2 | 170.2 | |
| Automatic debt dynamics [5/] | -5.8 | -3.3 | 4.9 | -12.0 | -7.1 | -6.0 | -4.6 | -3.6 | -3.2 | -36.5 | |
| Interest rate/growth differential [6/] | -8.0 | -9.8 | -7.4 | -12.0 | -7.1 | -6.0 | -4.6 | -3.6 | -3.2 | -36.5 | |
| Of which: real interest rate | -6.3 | -10.6 | -6.5 | -12.7 | -6.0 | -4.8 | -3.4 | -2.2 | -1.8 | -30.9 | |
| Of which: real GDP growth | -1.8 | 0.8 | -0.8 | 0.7 | -1.1 | -1.2 | -1.2 | -1.4 | -1.4 | -5.6 | |
| Exchange rate depreciation [7/] | 2.2 | 6.5 | 12.3 | ... | ... | ... | ... | ... | ... | ... | |
| Other identified debt-creating flows | -1.4 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Government and Public Sector Finance: privatization | -1.4 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Contingent liabilities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Please specify (2) (e.g., ESM and Euroarea loans) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Residual, including asset changes [8/] | 2.8 | -1.3 | -3.5 | 6.8 | 2.0 | 2.4 | 1.0 | 0.5 | 1.0 | 13.8 | |




Source: IMF staff.

1/ Public sector is defined as central government.

2/ Based on available data.

3/ EMBIG.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

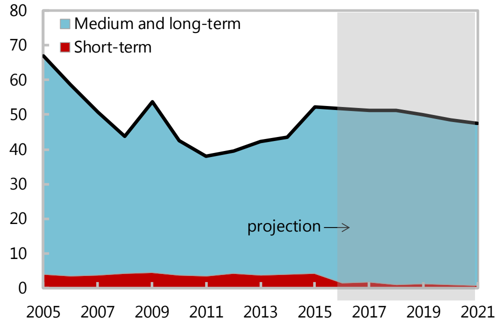
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year. Adjusted to exclude the impact from the real exchange rate depreciation.

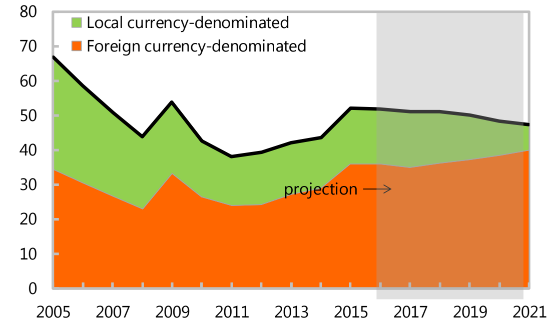
## Figure 2. Argentina: Public DSA—Composition of Public Debt and Alternative Scenarios

### Composition of Public Debt

**By Maturity**
(in percent of GDP)



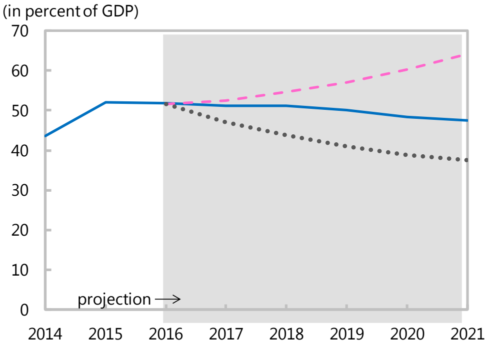

**By Currency**
(in percent of GDP)



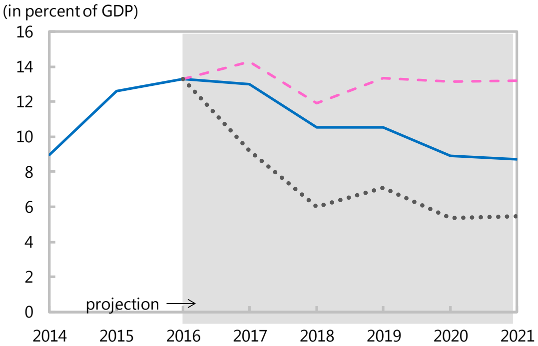

### Alternative Scenarios

Baseline — Historical — Constant Primary Balance

**Gross Nominal Public Debt**
(in percent of GDP)




**Public Gross Financing Needs**
(in percent of GDP)



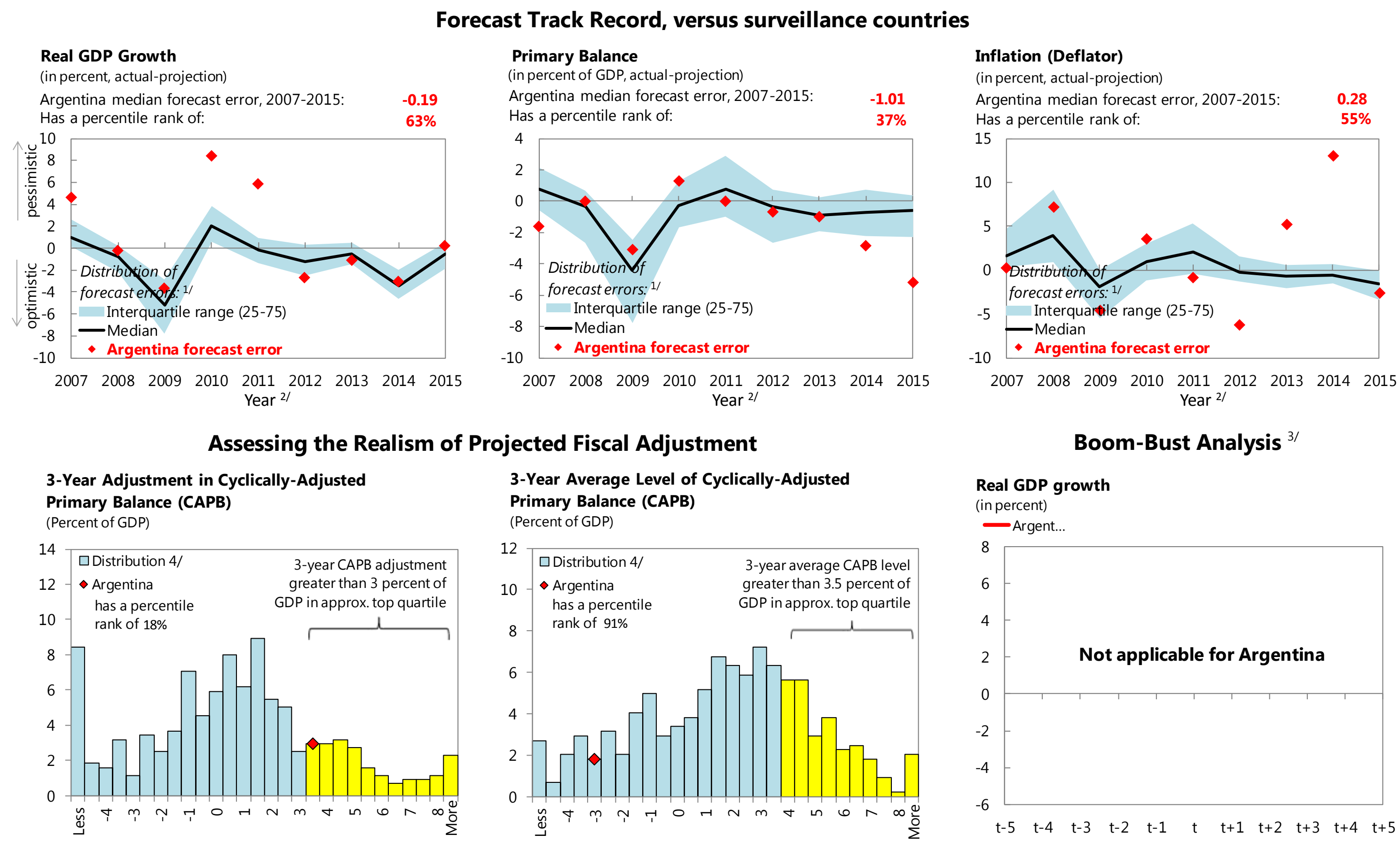

### Underlying Assumptions
(in percent)

| Baseline Scenario | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|
| Real GDP growth | -1.8 | 2.7 | 2.8 | 2.9 | 3.1 | 3.3 |
| Inflation | 40.6 | 22.6 | 19.4 | 15.3 | 11.5 | 9.6 |
| Primary Balance | -4.8 | -4.5 | -3.6 | -2.5 | -1.4 | -1.3 |
| Effective interest rate | 6.2 | 8.6 | 8.4 | 7.9 | 6.8 | 5.7 |
| **Constant Primary Balance Scenario** | | | | | | |
| Real GDP growth | -1.8 | 2.7 | 2.8 | 2.9 | 3.1 | 3.3 |
| Inflation | 40.6 | 22.6 | 19.4 | 15.3 | 11.5 | 9.6 |
| Primary Balance | -6.9 | -6.9 | -6.9 | -6.9 | -6.9 | -6.9 |
| Effective interest rate | 6.2 | 8.6 | 8.4 | 8.3 | 7.3 | 6.5 |

| Historical Scenario | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|
| Real GDP growth | -1.8 | 3.3 | 3.3 | 3.3 | 3.3 | 3.3 |
| Inflation | 40.6 | 22.6 | 19.4 | 15.3 | 11.5 | 9.6 |
| Primary Balance | -6.9 | -1.9 | -1.9 | -1.9 | -1.9 | -1.9 |
| Effective interest rate | 6.2 | 8.6 | 7.4 | 6.9 | 5.2 | 4.2 |

Source: Fund staff calculations and estimates.

## Figure 3. Argentina: Public DSA—Realism of Baseline Assumptions




Source : IMF Staff.

1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries.

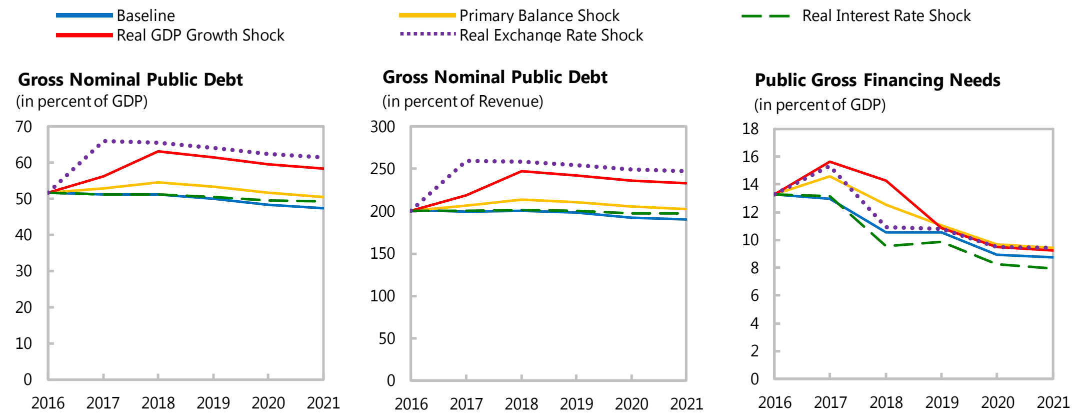
2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Argentina, as it meets neither the positive output gap criterion nor the private credit growth criterion.

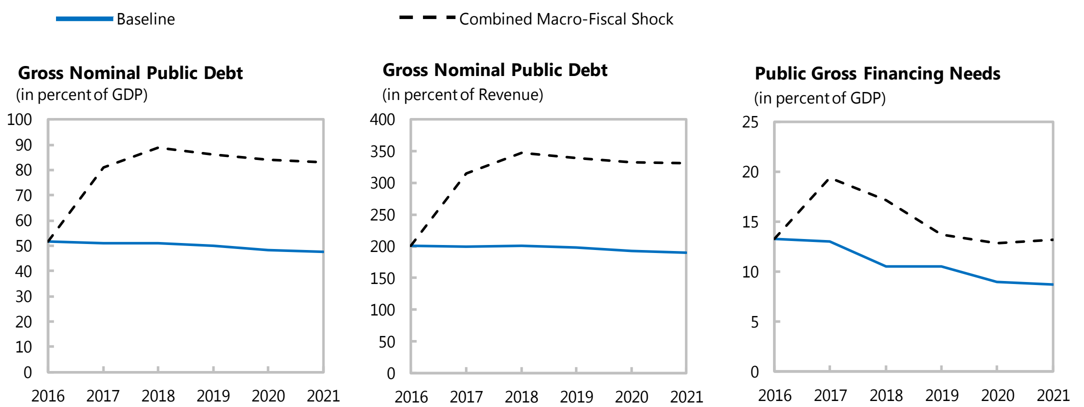
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

## Figure 4. Argentina: Public DSA—Stress Tests

### Macro-Fiscal Stress Tests




### Additional Stress Tests




### Underlying Assumptions
(in percent)

| **Primary Balance Shock** | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|
| Real GDP growth | -1.8 | 2.7 | 2.8 | 2.9 | 3.1 | 3.3 |
| Inflation | 40.6 | 22.6 | 19.4 | 15.3 | 11.5 | 9.6 |
| Primary balance | -6.9 | -7.4 | -6.1 | -3.3 | -2.2 | -2.0 |
| Effective interest rate | 6.2 | 8.6 | 8.6 | 8.1 | 7.0 | 5.8 |
| **Real Interest Rate Shock** | | | | | | |
| Real GDP growth | -1.8 | 2.7 | 2.8 | 2.9 | 3.1 | 3.3 |
| Inflation | 40.6 | 22.6 | 19.4 | 15.3 | 11.5 | 9.6 |
| Primary balance | -6.9 | -5.8 | -4.5 | -3.3 | -2.2 | -2.0 |
| Effective interest rate | 6.2 | 8.6 | 8.8 | 9.0 | 8.3 | 7.5 |
| **Combined Shock** | | | | | | |
| Real GDP growth | -1.8 | -2.5 | -2.5 | 2.9 | 3.1 | 3.3 |
| Inflation | 40.6 | 21.3 | 18.1 | 15.3 | 11.5 | 9.6 |
| Primary balance | -6.9 | -7.8 | -8.4 | -3.3 | -2.2 | -2.0 |
| Effective interest rate | 6.2 | 11.3 | 8.3 | 8.6 | 8.2 | 7.4 |

| **Real GDP Growth Shock** | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|
| Real GDP growth | -1.8 | -2.5 | -2.5 | 2.9 | 3.1 | 3.3 |
| Inflation | 40.6 | 21.3 | 18.1 | 15.3 | 11.5 | 9.6 |
| Primary balance | -6.9 | -7.8 | -8.4 | -3.3 | -2.2 | -2.0 |
| Effective interest rate | 6.2 | 8.6 | 8.5 | 8.6 | 7.7 | 6.6 |
| **Real Exchange Rate Shock** | | | | | | |
| Real GDP growth | -1.8 | 2.7 | 2.8 | 2.9 | 3.1 | 3.3 |
| Inflation | 40.6 | 39.9 | 19.4 | 15.3 | 11.5 | 9.6 |
| Primary balance | -6.9 | -5.8 | -4.5 | -3.3 | -2.2 | -2.0 |
| Effective interest rate | 6.2 | 11.3 | 7.8 | 7.9 | 7.2 | 6.3 |

Source: IMF staff.

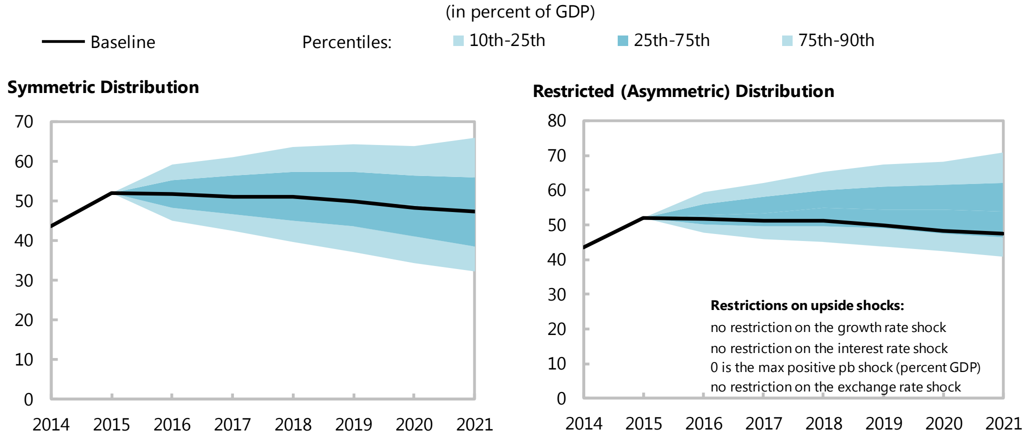
## Figure 5. Argentina: Public DSA—Risk Assessment

### Heat Map

| | | | | | |
|---|---|---|---|---|---|
| Debt level [1/] | Real GDP Growth Shock | Primary Balance Shock | Real Interest Rate Shock | Exchange Rate Shock | Contingent Liability shock |
| Gross financing needs [2/] | Real GDP Growth Shock | Primary Balance Shock | Real Interest Rate Shock | Exchange Rate Shock | Contingent Liability Shock |
| Debt profile [3/] | Market Perception | External Financing Requirements | Change in the Share of Short-Term Debt | Public Debt Held by Non-Residents | Foreign Currency Debt |

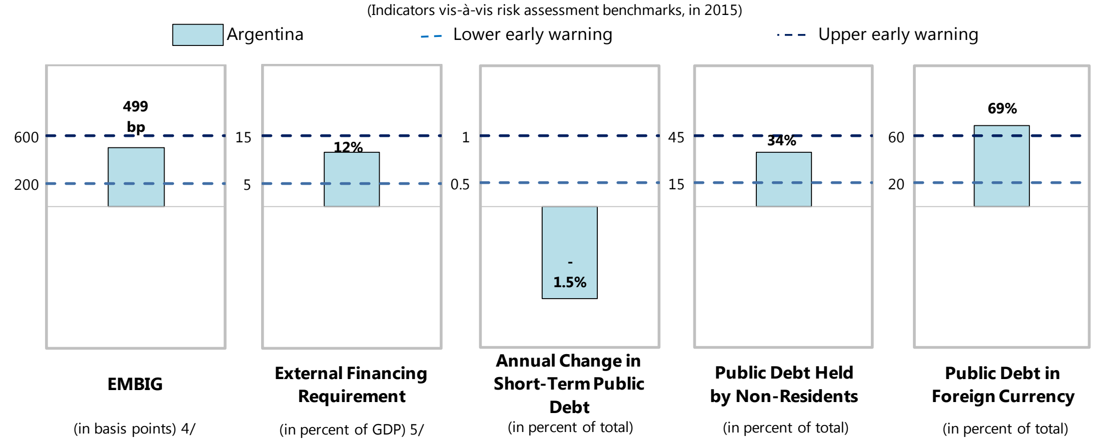
### Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)




### Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2015)




Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG, an average over the last 3 months, 03-Mar-16 through 01-Jun-16.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

INTERNATIONAL MONETARY FUND

# ARGENTINA

## STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

October 19, 2016


Prepared By

The Western Hemisphere Department
(In consultation with other departments)


## CONTENTS

# FUND RELATIONS

The 2016 Article IV discussions were held in Buenos Aires and Cordoba during September 19–30. The staff team comprised R. Cardarelli (head), L. Lusinyan, J. Canales-Kriljenko, D. Singh (all WHD), M. Ortiz Villafañe (WHD, local economist), P. Dudine (FAD), L. Jacome (MCM), A. Pienkowski (SPR), Ch. DeLong, and F. Figueroa (both LEG). J. L. Saboin (WHD) provided research assistance. Mr. Werner (WHD) joined the concluding meetings. The mission met with senior officials and representatives of private sector, finance industry, academics, and think-tanks. Mr. Torres (OED) participated in the meetings.

**Membership Status**: Joined September 20, 1956; Article VIII

(As of August 31, 2016)

| **General Resources Account**: | **SDR Million** | **Percent of Quota** |
|---|---|---|
| Quota | 3,187.30 | 100.00 |
| IMF Holdings of Currency | 2,919.57 | 91.60 |
| Reserve Tranche Position | 267.75 | 8.40 |

| **SDR Department**: | **SDR Million** | **Percent of Quota** |
|---|---|---|
| Net cumulative allocation | 2,020.04 | 100.00 |
| Holdings | 1,785.48 | 88.39 |

**Outstanding Purchases and Loans**: None.

**Latest Financial Arrangements**:

| Type | Date of Arrangement | Expiration Date | Amount Approved (SDR Million) | Amount Drawn (SDR Million) |
|---|---|---|---|---|
| Stand-By | Sep 20, 2003 | Jan 05, 2006 | 8,981.00 | 4,171.00 |
| Stand-By | Jan 24, 2003 | Aug 31, 2003 | 2,174.50 | 2,174.50 |
| Stand-By | Mar 10, 2000 | Jan 23, 2003 | 16,936.80 | 9,756.31 |
| of which SRF | Jan 12, 2001 | Jan 11, 2002 | 6,086.66 | 5,874.95 |

**Overdue Obligations and Projected Payments to Fund** 1/
(SDR Million; based on existing use of resources and present holdings of SDRs):

| | Forthcoming | | | | |
|---|---|---|---|---|---|
| | 2016 | 2017 | 2018 | 2019 | 2020 |
| Principal | | | | | |
| Charges/Interest | 0.02 | 0.19 | 0.19 | 0.19 | 0.19 |
| Total | 0.02 | 0.19 | 0.19 | 0.19 | 0.19 |

1/ When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

**Implementation of HIPC Initiative**: Not Applicable.

**Implementation of Multilateral Debt Relief Initiative (MDRI)**: Not Applicable.

**Implementation of Catastrophe Containment and Relief (CCR)**: Not Applicable.
As of February 4, 2015, the Post-Catastrophe Debt Relief Trust has been transformed to the Catastrophe Containment and Relief (CCR) Trust.

**Exchange Rate Arrangements**: Argentina's currency is the Argentine peso. The exchange rate arrangement is classified as floating from December 17, 2015. Argentina has accepted the obligations of Article VIII, Sections 2, 3, and 4. As part of the 2016 Article IV Consultation mission to Argentina, a review of the exchange system for compliance with Article VIII, Sections 2(a) and 3 of the Articles of Agreement was conducted. The restrictive exchange regime put in place in 2011 (the "*cepo cambiario*") has been removed, and Argentina maintains an exchange rate system free of restrictions on payments and transfers for current international transactions, other than restrictions notified to the Fund under Decision No. 144 (52/51).

**Last Article IV Consultation**: The Staff Report for the 2006 Article IV Consultation with Argentina was considered by the Executive Board on July 28, 2006.

# STATISTICAL ISSUES

(As of October 3, 2016)

### I. Assessment of Data Adequacy for Surveillance

**General**: Data provision is adequate for surveillance, although structural breaks in a number of macroeconomic series (including CPI, employment, unemployment, poverty) hamper empirical analysis. The status of Argentina with respect to the accuracy of the CPI and GDP data will be reassessed by the IMF Executive Board on November 9.

**National Accounts**: In June 2016, INDEC disseminated a new GDP series for 2004–15., which the IMF Executive Board assessed in August 2016 to be in line with international standards. INDEC published a methodology note and detailed estimates by economic activity of the GDP in September 2016. These actions increase data availability and transparency of the national accounts.

**Price statistics**: A new CPI was disseminated in June 2016 with coverage restricted to Greater Buenos Aires. At the request of INDEC, an IMF technical assistance mission visited Buenos Aires during September and October 2016 to assess progress on improving CPI methods and to assist with developing a national CPI. By October 2016, INDEC is planning to develop and disseminate a national CPI that is scheduled for release in early 2019, using data from a new household expenditure survey to be compiled in 2017–18.

**Government Finance Statistics**: Argentina disseminates data for general government operations, central government operations, and central government debt.

**Monetary and Financial Statistics**: Only highly summarized data for the central bank and other depository corporations are reported to STA. Data for other financial corporations, such as insurance companies, pension funds, and investment funds, are not reported.

**Financial sector surveillance**: Data for the core and nine encouraged FSIs are reported quarterly.

**External sector statistics**: Argentina disseminates timely balance of payments, International Investment Position (IIP), external debt, and the statistical framework of international reserves and foreign currency liquidity, but the periodicity of the IIP is annual rather than quarterly. Data provision is under the fifth edition of the Balance of Payments Manual (BPM5), circumstance that contributes to Argentina's argument for not recording liabilities pertaining to SDR's allocations in the balance of payments and IIP. Data re-disseminated by STA and converted to the updated balance of payments manual, BPM6, includes these data, although it may be absent in external debt reported to the World Bank. At the request of the authorities, a technical assistance mission on external sector statistics will visit the National Institute of Statistics and Census (INDEC) in November 2016. INDEC is the agency in charge of compiling and disseminating the balance of payments and IIP. The main emphasis of the mission will be to assist the authorities to facilitate the provision of quarterly IIP data.

### II. Data Standards and Quality

Subscriber to the Fund's Special Data Dissemination Standard (SDDS) since 1996.

No Data ROSC has been conducted.

### III. Data Submission to STA

Argentina does not report GFS data for publication in International Financial Statistics (IFS) and its last submission for the Government Finance Statistics Yearbook (GFSY) was in 2004. The authorities are encouraged to resume the regular data submission for the IFS.

## Argentina—Table of Common Indicators Required for Surveillance

(As of October 3, 2016)

| | Date of latest observation | Date received | Frequency of data[6] | Frequency of reporting[6] | Frequency of publication[6] |
|---|---|---|---|---|---|
| Exchange Rates | October 3, 2016 | October 3, 2016 | D | D | D |
| International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1] | October 3, 2016 | October 3, 2016 | D | D | D |
| Reserve/Base Money | October 3, 2016 | October 3, 2016 | D | D | D |
| Broad Money | October 3, 2016 | October 3, 2016 | D | D | D |
| Central Bank Balance Sheet | August 2016 | September 2016 | M | M | M |
| Consolidated Balance Sheet of the Banking System | August 2016 | September 2016 | M | M | M |
| Interest Rates[2] | October 3, 2016 | October 3, 2016 | D | D | D |
| Consumer Price Index | August 2016 | September 21, 2016 | M | M | M |
| Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4] | 2015 | February 2016 | A | A | A |
| Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government | August 2016 | September 21, 2016 | M | M | M |
| Stocks of Central Government and Central Government –Guaranteed Debt[5] | Q2 2016 | June 30, 2016 | Q | Q | Q |
| External Current Account Balance | Q2 2016 | September 20, 2016 | Q | Q | Q |
| Exports and Imports of Goods | August 2016 | September 27, 2016 | M | M | M |
| GDP/GNP | Q2 2016 | September 22, 2016 | Q | Q | Q |
| Gross External Debt | Q2 2016 | September 20, 2016 | Q | Q | Q |
| International Investment Position[7] | Q2 2016 | September 20, 2016 | Q | Q | Q |

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and provincial governments.
[5] Including currency and maturity composition.
[6] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).
[7] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

# RELATIONS WITH THE WORLD BANK[1]

The current Country Partnership Strategy (FY15–FY18) was presented to the World Bank Board of Executive Directors in September 2014. The CPS, developed in consultations with the Government, is built around nine specific results, most of which are aligned with the Government's Pobreza Cero goal of eradicating poverty (e.g., access to safe drinking water; youth insertion into labor market; effective health care coverage; environmental clean-up). The Bank Group resumed lending to Argentina after more than three years in 2014 with the first set of IBRD operations explicitly focusing and directly supporting the vulnerable and the poor.

Currently, the IBRD portfolio consists of 21 investment projects for a total commitment of US$5.8 billion (average size US$275 million) and of 3 big trust funds (two of GEF and one Montreal Protocol TF) for a total of US$23.4 million. The overall approximate lending envelope for the four-year CPS period is between US$4 billion and US$4.8 billion, US$2.4 billion of which has already been committed. The portfolio includes ten new operations approved by the Board under the new Country Partnership Strategy. As of June 30, 2016, Argentina's exposure to the World Bank Group was US$6,862 million (exposure to IBRD was US$ 5,737 million).

The Bank has agreed with the government on the lending program for FY17. In addition to the three operations already approved in the water, social protection and trade areas for a total amount of US$845 Million, the package includes a project to support financing of small and medium enterprises, two urban transformation projects, a water and sanitation project, an energy renewables guarantee, an additional financing for the Metropolitan Urban Transport Project, and a state modernization project.

IFC has committed $1.9 billion (during FY15–FY16) in 22 projects, consisting of $1 billion from its own account and $895 million in mobilization. The 22 projects of the IFC portfolio comprise 14 long-term finance projects ($344 million IFC + $895 million mobilization) and 8 trade finance projects—$672 million. As of end-FY16, the IFC portfolio stood at $1.7billion with 40 Projects. IFC is on target to reach and potentially overshoot the investment commitment targeted for end FY18 ($1.7 billion).

# RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK[2]

Argentina's current Country Strategy covers the period 2012–15, and focuses on interventions and funding for two critical areas: the Norte Grande region and the Greater Buenos Aires area. The first of these areas exhibits the lowest relative level of economic development in the country, together with the highest incidence of poverty and social exclusion. The second suffers from high levels of

[1] Prepared by the World Bank staff.

[2] Prepared by the Inter-American Development Bank staff.

social exclusion, with major challenges for urban sustainability. Given the proposed geographic focus, the Bank's strategy is based on the following objectives: the alleviation of obstacles to growth with a special focus in Norte Grande; social and economic inclusion of the population, focused on both regions; and urban sustainability and habitat improvement, with particular emphasis on the Greater Buenos Aires area. The IDB is the main multilateral creditor of Argentina with a total debt owed of US$11.2 billion in 2015 (53.6 percent of Argentina's total multilateral debt).

Under the 2012–15 Strategy the following initiatives were approved: 15 sovereign guarantee operations totaling US$2.6 billion, 28 private sector (non-sovereign guarantee) operations totaling US$ 325.1 million, and 29 non-reimbursable technical cooperations for US$12 million. In addition, another 3 sovereign guarantee operations for US$353 million and 4 technical cooperations for nearly $1 million were approved in the first nine months of 2016.

As of September 2016, Argentina's sovereign loan portfolio is composed of 47 operations, totaling US$7.5 billion, with a disbursed percentage of nearly 58 percent. The portfolio is distributed as follows: 36 percent dedicated to projects in the areas of infrastructure and energy, 28 percent in climate change and sustainable development, 25 percent in institutions for development, 6 percent in social sector, and 4 percent in integration and trade. Additionally, the private sector loans portfolio comprises 13 operations with an approved value of US$247.5 million, and the non-reimbursable technical cooperation portfolio includes 30 operations, with an approved value of US$30.7 million.

**Argentina: Approved Operations Under the 2012–15 Strategy and Transition Period**

| | **2012–15 Country Strategy** | | **January–September 2016** | |
|---|---|---|---|---|
| | Number of operations | Amount (US$ million) | Number of operations | Amount (US$ million) |
| Sovereign guarantee | 15 | 2,614 | 3 | 353 |
| Non-sovereign guarantee | 28 | 325.1 | 0 | 0 |
| Technical cooperation | 29 | 12 | 4 | 0.97 |

**Argentina: IDB Portfolio by Type of Operation***
(As of September 30, 2016)

| | Number of operations | Amount (US$ million) |
|---|---|---|
| Sovereign guarantee | 47 | 7,485 |
| Non-sovereign guarantee | 13 | 247.5 |
| Technical cooperation | 30 | 30.7 |

*Excluding closed and fully disbursed operations.

| Argentina: Sovereign Loan Portfolio by Sector* (As of September 30, 2016) | | | |
|---|---|---|---|
| Sectors | Number of operations | Current approved (US$ million) | Disbursed (Percent) |
| Infrastructure and Energy | 17 | 4,510 | 61.8 |
| Climate Change and Sustainable Development | 13 | 1,583 | 50.4 |
| Institutions for Development | 12 | 753 | 46.3 |
| Social Sector | 3 | 630 | 59.9 |
| Integration and Trade | 2 | 9 | 37.5 |
| **TOTAL** | **47** | **7,485** | **57.7** |
| *Excluding closed and fully disbursed operations. | | | |

**Argentina—Statement by the Staff on the Article IV Consultation**
**November 9, 2016**

This note reports on information that has become available since the staff report was issued and does not alter the thrust of the staff appraisal.

**Economic outlook.** The monthly indicator of economic activity showed positive 0.2 percent (m/m) growth in August, the first time since March, but GDP is expected to have contracted again in Q3. Construction activity fell by 13 percent (y/y) in September and industrial production fell by around 7 percent (y/y) in Q3, driven by continued weakness in the automotive sector. Private consumption indicators were mixed, with consumer confidence increasing 6.3 percent in October but retail sales continuing to fall in real terms in August. The trade balance continued to improve in September, mainly due to subdued imports.

**Monetary policy**. The central bank has maintained the policy rate unchanged for the past six weeks at 26.75 percent, noting that inflation expectations for 2017 remain slightly above the 12–17 percent target (median inflation expectations for December 2017 were 19.7 percent in October, slightly below the 20 percent expected in September). The construction and retail sectors completed the second stage of their annual wage negotiations, which led to annual salary increases of slightly below 40 percent in both cases.

**Fiscal policy**. The fiscal deficit widened in September, with primary spending increasing at close to 37 percent (y/y), mainly reflecting increase in transfers to the private sector following the utilities tariff rollback. The authorities have announced a bonus in December for those receiving the minimum pension and beneficiaries of social transfers, with an estimated fiscal cost of around 0.2 percent of GDP. The first round of the tax amnesty ended on October 31 with a better-than-expected result of about US$4.6 billion declared in cash terms.

**Debt issuances and FX reserves**. The Treasury successfully issued 7 and 10 years fixed-rate peso bonds in October. Although conducted in the domestic market, the transactions attracted substantial interest from foreign investors, generating FX inflows that increased reserves to close to US$40 billion in late October (the highest level since mid-2013, up from around US$30 billion at end September). This allowed the central bank to pay back a US$2.5 billion loan from the BIS. The province of Buenos Aires managed to raise US$750 million, totaling US$3 billion year-to-date, while Santa Fe raised US$250 million in its first ever international debt sale.

**Legislative progress**. The lower house approved with a large majority the 2017 Budget with an overall deficit target for next year of -4.2 percent of GDP as in the original proposal. The Budget contains the obligation for provinces to reduce the fiscal deficit by 10 percent next year relative to the 2016 outturn. The lower house also approved a bill that limits government’s authority to reallocate spending without Congressional approval to 7.5 percent of total spending in 2017, falling to 5 percent in 2018. Finally, the lower house approved a bill that redesigns an institutional framework for public-private partnership investment projects. All bills now move to the Senate for final approval.

**Statement by Mr. Torres, Executive Director, on Argentina**
**November 9, 2016**

**This is Argentina's first Article IV Consultation in ten years**. In that period Argentina was the only G20 member that did not open its books to the Fund's scrutiny. That has radically changed. Since December 2015, Argentina's statistics agency recovered its independence and its reports' integrity. As I will explain below, Argentina is now looking its problems in the eye and tackling them decisively. It is also complying with its responsibilities with the international community, and as such, my authorities have consented to the publication of this Article IV report. I turn now to address the policies that are being implemented to redress Argentina's macroeconomic imbalances.

**Populism left the country in tatters**. By December 2015 Argentina was running down its reserves, despite having imposed self-inflicting restrictions in access to foreign exchange. The country was bound to a balance-of-payment crisis, but the previous government kept kindling domestic demand by subsidizing consumption and over-staffing the public sector.[1] Imports essential to the industry were delayed or simply blocked, putting firms and jobs at serious risk. Decadent public infrastructure, high transaction costs, and the practice of protecting cronies and using the tax-agency to bully "unruly" entrepreneurs made Argentina a "no-go" zone for investors. Productivity and competitiveness plunged[2], the economy stagnated (since 2011) and entered in a recession cycle in Q4 2015. Fiscal deficits were handsomely financed by money-printing and deposits at public institutions. Inflation was close to 30 percent (according to private estimates, as nobody trusted the "Orwellian" official figures). The crisis was imminent. What has changed?

**Change is everywhere**. I do not want to sound self-complacent because problems are still looming large, yet it is only fair to note that in just 11 months in office President Macri's administration has achieved much more than what we could have reasonably expected. To begin with, the crisis was averted and after 9 years of rigging statistics, economic agents are once again believing in the official word.

**Disassembling the bomb**. Foreign exchange controls were successfully dismantled. The country has now a single and floating exchange rate and access to foreign currencies is unrestricted. Export taxes were eliminated (except for those on soy-beans, which were reduced) and the litigation with creditors that had held-out from Argentina's debt restructuring was successfully settled. This allowed the country to regain access to credit markets. In April 2016, for the first

[1] From 2001-2014 the number of public sector employees grew by 70 percent, with provinces and municipalities being accountable for over 80 percent of this increase.

[2] In the competitiveness index prepared by the Global Economic Forum, between 2005 and 2015 Argentina descended from 54th position to 106th position.

time in 15 years, Argentina could tap international capital markets issuing bonds for US$ 16.5 billion. The issuance was four times oversubscribed and the money was mostly used to settle the claims of the aforementioned holdout creditors, putting behind 15 years of litigation.

**Bridling inflation**. Just a few days after taking office the government pledged to bring down annual inflation to about 5 percent by 2019 (see target-band below) and, together with the virtually overnight removal of foreign exchange controls, the Central Bank of Argentina (BCRA) announced the transition to an inflation-targeting regime. The aforementioned regime was formally launched on September 26.[3] As staff notes, the targets are ambitious, yet inflation is already slowing down rapidly. In September, consumer prices increased by 1.1 percent (a far cry from the 2.1 percent monthly average in 2012-2015[4]) and wholesale prices just 0.4 percent. Perhaps even more telling is that consensus expectations for 2017 are currently at 19.8 percent, already very close to next year's upper limit of the band.

| Inflation - Targets | 2017 | 2018 | 2019 |
|---|---|---|---|
| | 12%-17% | 8%-12% | 3,5%-6,5% |

The Central Bank's commitment to delivering lower inflation is very clearly shown in the reduction of monetary financing of the Treasury: BCRA transfers to the government were reduced by half in real terms in 2016 over the previous year, and are planned to be cut even further in 2017, when they will represent only a third of their 2015 amount in terms of GDP.

**Markets are voting with their feet for tamed inflation**. On October 13 the government launched a new series of local bonds, denominated in Argentine pesos, with 10 and 7-year maturity and with a fixed nominal interest rate. Thirteen bonds were placed and the issuance was comfortably oversubscribed. Given Argentina's un-glorious record of high inflation, this was quite an achievement. However, the inverted yield-curve was even more remarkable showing that investors were ready to accept lower yields for the longer-term bonds (15.5 percent vs. 16 percent, respectively).

**Gradual and relentless fiscal consolidation**. In 2015 the fiscal primary deficit was over 5 percent of GDP, the economy was in recession, and (as I will explain below) about 1/3 of Argentineans did not have sufficient income to cover their very basic needs. This was a dramatic situation, yet the government had no choice. It rapidly set out a roadmap for fiscal consolidation and, as staff rightly notes, fiscal tightening will be relentless all over President Macri's administration. One of the first measures was to dismount energy subsidies that overall amounted to approximately 4 percent of GDP (in 2015). Beyond being costly, these subsidies were economically, environmentally, and socially perverse. On the one hand, they created incentives

---

[3] http://www.bcra.gov.ar/Noticias/Regimen_de_Metas_de_Inflacion_en_Argentina.asp

[4] As recorded by the Statistical Agency of the City of Buenos Aires, which published its own CPI. It should be noted that in August, CPI as published by INDEC, was artificially low (0.2 percent) following a ruling from the Supreme Court that required reversing gas-price increases.

for energy over-consumption; on the other hand, they benefited mostly the affluent and forced a country with abundant gas reserves to import an increasingly large part of the gas, oil, and electricity it needed. Prices are now being progressively reconciled with the actual cost of production. Admittedly, this painful process has been rather tortuous, as injunctions forced the government to temporarily reverse price increases. Nevertheless, energy subsidies are already being progressively phased out and in 2017 savings will come close to 1 percent of GDP.

**The drop in output has bottomed out**. Despite a short-lived uptick in 2015 fueled by pre-electoral fiscal stimulus, the economy had been stagnant since 2011 and started contracting in the last quarter of 2015. When the new administration took office it had little wiggling room for counter-cyclical fiscal policies. Rather, it had to face unpaid bills that had been pushed forward by the previous administration; urgently address the aforementioned perverse structure of energy subsidies; and remove the exchange rate controls. Moreover, it also had to pause ongoing public works to take a close look at the integrity of pending bills. As a result, the contraction was more prolonged and severe than expected. Nevertheless, output has bottomed out in the third quarter of 2016 and the year will end with a slightly positive growth rate. Activity is already picking up in several sectors; most notably in construction (anticipated by a 16 percent increase in cement deliveries in July and August) and the government's growth projection for 2017 is 3.5 percent (from a negative rate of 1.5 percent expected for this year). It is worth noting that the government's 3.5 percent growth projection is on the conservative side, as most private consultants (including some advising the political opposition) are much more sanguine.

**Some differences with staff**. I do not want to take issue with staff's projections but will note a few points. Let me start by acknowledging staff's difficulties in assessing changes in the quality of public expenditures. It is always difficult to discern how improvements in quality could affect the fiscal multiplier. The challenge for staff was compounded by the fact that Article IV consultations were interrupted for the last 10 years. Yet, it is important to note that whatever the "quality-enhanced" multiplier may be, the effect of public money spent on a road that is heavily overpriced could be dramatically different from that of public money spent on a reasonably priced road that is actually delivered.

It is also important to note that some of the staff's projections bode ill with their assumptions. For instance, in a world with low or squarely negative interest rates, staff assumes that Argentina's real interest rates will be between 4-5 percent until 2019 (Table 5). However, despite these unusually positive interest rates, gross national savings remain almost unchanged over the entire five-year period covered by staff's forecast (Table 1).

Staff notes that Argentina's banking sector is currently mostly "transactional". This explains that credit to GDP ratio is unusually low (13.5 percent according to staff[5] and just 12 percent according to BCRA estimates). Nonetheless, with such a low start, staff projects slightly less than a 1 percent annual increase (average) for credit to the private sector over the five-year period covered by the report (Table 1).

It is also important to note that staff is understating Argentina's capacity to rebuild its gross international reserves. Without going any further, staff is projecting US$ 36.5 billion of reserves for end 2017, whereas by the end of October 2016 they were already standing at approximately US$ 40 billion.[6]

Finally, staff is also understating the government's fiscal effort as it fails to mention its endeavor to re-capitalize the BCRA. Indeed, it has exchanged the non-transferable IOUs that the previous administration had used to "buy" reserves from the central bank, with tradable bonds that are actually paying interests (approximately US$ 1 billion since the government took office in 2016).

**Argentina's shame: a rich country with an impoverished population**. In June 2015 the previous government pretended that poverty had almost been eradicated from Argentina (just under 5 percent of the population was deemed to be under the poverty line). As soon as the new administration took office it decided to truly eradicate poverty, but also the practice of tailoring official statistics to political expectations. Today, quite a different reality is exposed to the daylight. Almost one out of every three adults is under the poverty line and about 40 percent of children do not have sufficient means to cover basic needs. This is unforgivable in a rich country that is just emerging from a decade of record commodity prices.

The authorities know that a vibrant economy is the best way to create jobs, restore dignity and pull people out of poverty. However, the inherited reality is just too dramatic, leaving no time to wait-and-hope. President Macri has publicly stated that reducing poverty is his administration's absolute priority and that by the end of his period he expects to be judged by how effectively he delivers on that objective. The government is implementing very active social policies, including many that come from the previous administration; nevertheless, for a change it is delivering hand-outs transparently and not exchanging them for political support. Moreover, it needs to be underscored that the government is putting special emphasis on training programs to revamp and increase the working skills of those that have been striving in the informal economy. All in all, Social Services will represent 64 percent of total public expenditures in 2017, which are about 15

[5] Paragraph 36 of the staff report.

[6] During October 2016 they increased by approximately US$ 7 billion and by October 27 they were standing at US$ 39,841 billion. By October 31st they fell to 37.210 as the BCRA decided to pre-pay US$ 2.5 billion to the BIS.

percent of GDP.[7] These transfers are indispensable to help the most vulnerable deal with this stage of relative price variations and macro-economic rebalancing.

[7] Among the main social programs is “Plan Nacional de Primera Infancia” (National Plan for Early Childhood) which was launched at the beginning of 2016, whose objective is to eradicate malnutrition in children under the age of 4. In education, in 2017 the national system will include all children over the age of 3; this will benefit more than 638,000 children. Moreover, 3,000 new kindergartens will be built before 2019. Recently, a national survey “Aprender” was conducted to gain a broad picture and learn where the educational situation stands so that the education policy can provide adequate measures. It is also worth noting that the “Asignación Universal por Hijo”, a program created by the previous government that reaches 3.8 million children, is being maintained, enlarged, and enhanced and now aims to add an additional 1 million infants with increased benefits.

Other programs that transfer income to the poor will also continue, such as “Argentina Trabaja” and “Ellas Hacen”, albeit ensuring transparency and effectively ring-fencing transfers from all political interference. Moreover, a new law approved by Congress refunds low-income households and pensioners 15 percentage points on VAT collected on all debit card purchases, the minimum wage will also be increased by 33 percent in three stages, and important programs on housing, water, transport, and health are underway. SMEs are also benefiting from several measures and increased credit.