Press Information Notice (PIN) No. 98/9
FOR IMMEDIATE RELEASE
February 23, 1998

International Monetary Fund
Washington, D. C. 20431 USA

IMF Concludes Article IV Consultation with Argentina

The IMF Executive Board on February 4, 1998 concluded the 1997 Article IV consultation[1] with Argentina.

Background

Argentina's robust recovery from the recession it experienced in 1995 and early 1996 continued in 1997 at a rapid pace, resulting in **real GDP** growth that is likely to have exceeded 8 percent for the year. Investment continued to drive growth, with output expanding strongly in energy, construction, the financial sector, and manufacturing. The economic recovery was accompanied by an improvement in the employment situation. The **unemployment** rate fell from 17.3 percent to 13.7 percent between October 1996 and October 1997 on the strength of a 7 percent job growth, while wages remained flat. Consumer price **inflation** remained near zero in 1997, while wholesale prices actually declined.

The **fiscal situation** improved significantly in 1997, despite ongoing transitional costs from the switchover to privately administered pension funds equivalent to some 1 percent of GDP a year The overall public sector deficit declined from 3.3 percent of GDP in 1996 to an estimated 1.9 percent in 1997, while the deficit of the federal government (including the costs associated with the reform of the civil service and the transfer to the federal level of certain provincial pension funds) fell from 2.2 percent of GDP to 1.4 percent. Federal government revenues rose by 0.8 percent of GDP, reflecting an increase in fuel taxes, higher revenues from corporate income taxes, and higher nontax revenue. Expenditures declined as a share of GDP, with civil

---

[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. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. In this PIN, the main features of the Board's discussion are described.

service and social security reforms contributing to contain outlays and offsetting increases in public investment, transfers to provincial governments, and interest payments.

Since 1995, the Argentine **banking sector** has been strengthened considerably. The number of financial institutions declined by about 20 percent and foreign-owned banks greatly increased their presence in the country. The average capital adequacy ratio (according to Basle criteria) rose from 18 percent to 20 percent by mid-1997, and the share of nonperforming assets declined somewhat. Central bank reserves climbed by more than US$3 billion in 1997, reaching US$22.8 billion by year-end, while commercial banks held some US$7 billion in liquid assets abroad. In addition, a contingent repo facility was established with foreign banks to provide liquidity to the banking system, in an amount equivalent to some 10 percent of the system's deposits, in the event of a crisis. Interest rates fell significantly in the first half of 1997, before a temporary rebound in the wake of the Asian crisis.

High domestic demand along with a strong U.S. dollar and a weak harvest contributed to a substantial increase in the **external current account** deficit, which moved from 1.9 percent of GDP in 1996 to an estimated 3.8 percent of GDP in 1997. Underlying this deterioration was the decline in the trade balance from near equilibrium in 1996 to a deficit of US$4.9 billion (1.5 percent of GDP) in 1997. Imports rose by 27 percent, while exports rose by 6½ percent. Import growth was particularly strong in capital goods (37 percent), but consumer goods imports were also robust (up 27 percent). The current account deficit was more than covered by a strong increase in **capital inflows**. Foreign direct investment climbed by nearly 60 percent to US$6½ billion, financing more than half of the current account deficit. A strong inflow of deposits to the banking system and external borrowing (most of it long-term) covered the remainder of the deficit and permitted an accumulation of foreign exchange reserves.

The authorities made further progress in **structural reforms** in 1997, building on the achievements in privatization, social security reform, and public sector restructuring already made since 1991. The medical benefits program for retirees (PAMI) was strengthened, management of the public social security system was rationalized, and several deficient provincial pension funds were taken over by the central government and set on the road to recovery. As regards privatization, the postal services were leased to the private sector and a number of provincial banks and utilities were sold.

So far, Argentina has weathered well the world capital **market turbulence** of the latter part of 1997. Interest rates increased markedly in late October and November, but have since declined to near pre-crisis levels. Confidence in the financial system remained high; deposits in the banking system (both in U.S. dollars and in Argentine pesos) continued to climb, as did central bank foreign exchange reserves. Argentina has seen no interruption in its access to international capital markets, albeit this has come at a somewhat higher cost. Since November, the government has floated bonds of up to 30 year maturity in diversified markets for more than US$1.7 billion and secured syndicated bank financing of US$2 billion.

A three-year **extended arrangement with the IMF** was approved on February 4, 1998 (see Press Release 98/1), for a total of SDR 2,080 million (45 percent of the country's quota on an annual basis). This arrangement is in support of the authorities' program of further fiscal consolidation and a deepening of structural reforms. The authorities have indicated that they do not intend to draw on this arrangement and will treat it as a "precautionary" arrangement to underpin their reform efforts. Under the program, the overall public sector deficit will be reduced to under ½ percent of GDP by 2000, with further reforms in taxation, fiscal relations with provincial governments, and the public social security system. A labor market reform will be implemented to boost job creation and competitiveness by improving wage and workplace flexibility. The government has undertaken to continue the privatization process—among other things, with the sale of the National Mortgage Bank (BHN) to be completed in 1998—and has announced its intention to privatize Banco de la Nación (the country's largest bank) later in the program period. Further financial sector reforms, including enhanced prudential regulations and steps to increase the efficiency and transparency of financial intermediation will be implemented The program also includes provisions for improvements in health care, poverty alleviation, the judicial system and public ethics, and education.

Executive Board Assessment

Executive Directors expressed satisfaction with the strong investment-led growth and continued absence of inflationary pressures in 1997. They welcomed the sharp drop in the rate of unemployment during the year, but noted that unemployment still remains at a relatively high level, reflecting continuing rigidities in the labor market. Directors commended the authorities for their macroeconomic and financial management during 1997, which had helped the country weather the recent turbulence in international financial markets. They noted that the continued growth of foreign exchange reserves and banking sector deposits, as well as the absence of public sector financing problems in late 1997, augured well for Argentina, but cautioned that external sector developments must be closely monitored.

Directors welcomed the authorities' desire to maintain a close dialogue with the IMF, and also welcomed the precautionary nature of the proposed extended arrangement. Some Directors observed that the proposed arrangement is especially important in view of the uncertainties induced by the current global market turbulence. In this environment, Directors attached importance to the authorities' commitment to take prompt action, if and as needed, to ensure achievement of the program targets, and welcomed the inclusion of special consultation clauses in the arrangement. They also welcomed the focus of the proposed program on key structural reforms.

Directors expressed satisfaction with the fiscal consolidation achieved during 1997, but underscored the importance of further fiscal adjustment. In view of the uncertainty surrounding the macroeconomic outlook and the prospective current account deficits, Directors stressed that the authorities need to stand ready to take further fiscal action should a revenue shortfall materialize, or should financing prove difficult in 1998. Directors welcomed the authorities' commitment to introduce by mid-1998 a comprehensive tax reform proposal, aimed at improving the efficiency and equity of the tax system, broadening the bases of the income tax and the value-added tax, and promoting the competitiveness of the economy. Directors noted that some progress had been made in 1997 in improving tax compliance, and encouraged the authorities to persevere with their efforts to strengthen the tax administration. Directors welcomed the authorities' intention to contain the overall growth of public spending, through better prioritization of expenditure programs and efforts to improve their transparency and efficiency. Several Directors also encouraged the authorities to undertake a comprehensive reform of intergovernmental fiscal relations, which should help strengthen the provinces' own revenue-generating capacity.

Directors commended the authorities for the progress made so far in strengthening, and modernizing the domestic financial system. They noted the consolidation in the banking system, the strengthening of the banks' capital and liquid reserve position, and improvements in the quality of banking sector assets. Directors welcomed the authorities' plans to firm prudential regulation and supervision further, as well as to improve dissemination of financial market information. They expressed support for the government's announced intention to privatize Banco de la Nación, and noted the importance of the privatization of remaining provincial banks for strengthening the financial system and to improving allocative efficiency and fiscal discipline.

Directors noted the substantial progress already made by Argentina in recent years in structural reforms, particularly in privatization, pension reform, and in the rationalization of the state. They welcomed the authorities' intentions to continue structural reforms in key areas of the economy and society, and the focus on second generation reforms. In particular, they noted the importance of labor market reform in promoting a further reduction in unemployment and continued external competitiveness. They welcomed the authorities' commitment to secure the early passage of a labor market reform package to significantly enhance labor market flexibility, including a significant reduction in dismissal costs and a progressive elimination of the "ultra-actividad". Directors also welcomed the government's determination to press ahead with the proposed reforms of the judicial system to improve its efficiency, especially in areas of macroeconomic relevance.

Directors noted that the external current account deficit had increased substantially in 1997, and stressed the importance of preventing a further deterioration in 1998, and of ensuring a gradual improvement in subsequent years, especially in view of the still high level of the external debt service in relation to exports. They noted, in particular, the growing regional concentration of Argentina's exports, and encouraged efforts to diversify export markets. Therefore, Directors encouraged the authorities to closely monitor current account developments. They noted that, although Argentina has had no difficulty in obtaining needed external financing so far, it remains vulnerable to changes in external market conditions. Therefore, Directors welcomed the authorities' commitment to take quick and decisive action to restrain domestic demand, should the current account deteriorate further or prospects for external financing worsen. Several Directors urged the authorities to press within MERCOSUR for the early reversal of the recent increase in the common external tariff.

Press Information Notices (PINs) are issued, at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies.

Argentina: Selected Economic Indicators

	1993	1994	1995	1996	Est. 1997
Real economy (change in percent)					
Real GDP	6.3	8.5	-4.6	4.2	8.1
Domestic demand	7.6	9.8	-8.4	5.9	10.8
CPI (end of period)	6.8	3.9	1.6	0.0	0.3
Unemployment rate (October, in percent)	9.2	12.2	16.4	17.3	13.7
Gross national savings (percent of GDP)	15.3	16.3	16.5	15.7	16.2
Gross national investment (percent of GDP)	18.4	20.0	18.0	17.7	20.0
Public finance (percent of GDP)					
Federal government balance	0.9	-0.5	-1.4	-2.2	-1.4
Overall public sector balance	-0.2	-1.7	-3.4	-3.3	-1.9
Total public debt	29.2	31.1	35.9	37.4	36.2
Money and interest rates					
Net domestic credit (change in percent)	21.0	19.1	5.7	4.0	13.1
Private sector deposits (change in percent)	54.1	19.7	-3.1	22.2	28.1
Interest rates (average, in percent per annum)					
90-day peso time deposits	12.8	8.8	13.1	7.3	7.0
30-day peso prime rate	12.3	10.1	17.8	10.5	9.1
Balance of Payments (in millions of US$)					
Trade balance	-2,427	-5,750	844	49	-4,892
Exports (f.o.b.)	13,117	15,841	20,967	23,811	25,360
Imports (c.i.f.)	-15,544	-21,591	-20,123	-23,762	-30,252
Current account 1/	-7,853	-10,341	-4,302	-5,781	-12,196
As percent of GDP	-3.0	-3.7	-1.5	-1.9	-3.8
External debt (percent of GDP)	23.4	24.7	24.4	25.9	26.3

Sources: Central Reserve Bank of Argentina, National Institute of Statistics, FIEL; and IMFstaff estimates.

1/ The authorities estimate a lower current account deficit (by about US$1.6 billion or 0.5 percent of GDP) on account of interests receipts imputed on assets held abroad by the private sector. Work on improving the estimation of these assets is underway.