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Argentina: First Review Under the Stand-By Arrangement and Exchange System—Staff Report; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Argentina

In the context of the first review under the Stand-By Arrangement and Exchange System, the following documents have been released and are included in this package:

- the staff report for the first review under the Stand-By Arrangement and Exchange System, prepared by a staff team of the IMF, following discussions that ended on **March 3, 2003,** with the officials of Argentina on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on March 10, 2003**. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff supplement of **March 17, 2003** updating information on recent economic developments.

- a Press Release summarizing the **views of the Executive Board as expressed during its March 19, 2003 discussion** of the staff report that completed the review.

- a statement by the Executive Director for Argentina.

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

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ARGENTINA

First Review Under the Stand-By Arrangement and Exchange System

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

Approved by John Dodsworth and G. Russell Kincaid

March 10, 2003

- **Stand-By Arrangement**. An arrangement for SDR 2.17 billion (US$2.9 billion, or 170 percent of quota on an annual basis) was approved by the Executive Board on January 24, 2003. The access was broadly equivalent to obligations (including expected charges) falling due during the period January–August 2003. In addition, all repurchase expectations during the period of the arrangement (amounting to SDR 2.8 billion) were converted to an obligations basis. The first tranche, SDR 747 million (US$986 million), was disbursed upon approval; completion of the first review would allow a purchase of SDR 226.2 million.

- **Discussions**. Discussions were held in Buenos Aires during February 24–March 3 with Minister of Economy Lavagna, Central Bank President Prat-Gay, and other senior officials and private sector representatives. The staff team comprising Messrs. Dodsworth (Head), Thornton, Giorgianni, Ramirez, and Ms. Cebotari (all WHD), Ms. Christopherson (LEG), Mr. Petri (FAD) and Ms. Ali (Administrative Assistant, WHD), was assisted by Mr. Cubeddu, the Fund resident representative. Mr. Singh (WHD) attended the final meetings, including with a broad spectrum of financial and political representatives. An overlapping MAE mission, led by Mr. Hoelscher, participated in the discussions. Mr. Zoccali (Alternate Executive Director) attended the policy meetings.

- **Economic Developments**. The economy shows signs of gradual improvement, but the underlying situation remains fragile. The quantitative performance criteria for the first review were observed, but there were delays in several structural areas, including public bank reform, banking regulations, and out-of-court workout legislation. A structural performance criterion (for which a waiver is requested) and a structural benchmark were not observed and are proposed to be reset for implementation by the second review.

- **Political Situation**. Presidential elections are scheduled for April 27, but the political situation remains unclear with opinion polls indicating that none of the leading five candidates has a decisive lead.

- **Supplementary Memorandum of Economic Policies**: In the attached SMEP, the authorities reaffirm their commitment to the program's key objectives, and describe recent policy implementation and their plans for the coming months.

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I. Background

1. **The details of policy implementation since approval of the Stand-By Arrangement in January are contained in the Supplementary Memorandum on Economic Policies (SMEP)** (Attachment II). All quantitative performance criteria for end-January were observed (Table 1), though some structural measures have been delayed. A waiver is being sought for nonobservance of one structural performance criterion, while two others are still pending (SMEP, Box 1).

II. Recent Developments

2. **Main developments since the approval of the arrangement are as follows:**

- **Recent indicators point to a continuing recovery** (Figure 1). Industrial production has registered strong growth, and retail and auto sales also show an increase signaling higher consumption. Consumer prices rose by 1.3 percent in January. On an annualized basis, inflation over the past four months was about 10 percent.

- **The end-January fiscal targets were met with comfortable margins** (Table 2). The federal primary surplus in January was almost double the programmed level largely due to higher income tax collections, in part, related to the early payment of the 13th month salary (*aguinaldo*).

- **The outturn for provincial finances for 2002 was better than expected with provinces broadly achieving primary balance**. For 2003, the governors of most of the large provinces have already signed bilateral agreements and the structural performance criterion in this area is expected to be met.

- **Base money growth has slowed considerably from the high levels at the end of 2002** (Table 3 and Figure 2). This slowing mainly reflected reduced purchases of foreign exchange (see below) and increased sales of central bank paper. The further liberalization of exchange controls also helped adherence to the monetary program. Short-term interest rates rose initially, but have slightly eased in recent auctions.

- **The peso has appreciated by about 5 percent against the U.S. dollar since end-December 2002**. Monthly foreign exchange purchases by the central bank are down from US$555 million in December 2002 to US$285 million in February 2003. Reflecting payments to IFIs, gross international reserves temporarily fell to US$9.3 billion in early February 2003 (from US$10½ billion at end 2002), but have since recovered to US$10.3 billion upon receipt of recently approved IFI disbursements.

III. Report on the Discussions

A. Macroeconomic Framework

3. **There was agreement that, given the uncertainties, it was too early to revise the macroeconomic framework or adjust the program targets** (Table 4) (SMEP, paragraph 2). While a consumption-based recovery is clearly under way, its underlying strength and sustainability are difficult to assess. Recent indicators suggest growth of 3–4 percent in 2003, rather than 2–3 percent in the program. However, private sector credit is still declining, and the response of the export sector to a significant gain in competitiveness has, so far, been quite feeble.[1] Price pressures have been subdued for some time. There is, thus, some likelihood that the program can overperform on the inflation forecast for 2003.[2]

B. Fiscal Policy

4. **The strong fiscal performance in January partly reflected temporary factors that boosted income taxes.** However, the authorities succeeded also in holding other elements of the budget closely in line with the program, including social safety net spending. Looking ahead, the authorities expressed confidence they could meet the fiscal targets through June, but noted the possibility of disruptive court challenges.[3] Staff discussed also the risk that, in the event of lower inflation and greater exchange rate appreciation relative to the program, there may be nominal revenue shortfalls. It was agreed that these risks would be re-assessed at the second review.

5. **Congressional approval of structural fiscal measures is still pending**. Passage of two tax measures and the elimination of remaining competitiveness plans is, however, expected in the coming days (SMEP, paragraph 3).

6. **There was a shortfall in programmed external financing through end-February**. The shortfall, which has resulted in increased dependence on central bank credit, largely relates to World Bank disbursements that were affected by a delay in arrears clearance and issues related to implementation (Table 5). Bank staff noted that they had moved swiftly to reactivate cooperation, including existing loans, and expect to be able to disburse programmed amounts provided the authorities comply with agreed actions included in loan

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[1] See Annex I for details of recent developments in export competitiveness, and Annex II for an update on poverty developments.

[2] The central bank has already announced a 22 percent target for the year.

[3] A court has recently ordered that the restoration of last year's 13 percent cut in pensions should be paid in cash rather than bonds; this would cost Arg$1.3 billon. The government has appealed the ruling. In addition, courts may rule that firms should be allowed to adjust their corporate income tax returns for inflation, which would undermine revenues.

agreements, including existing adjustment operations. The program has been adjusted to rephase the shortfall in disbursements to March.

C. Monetary and Exchange Policy

7. **The authorities saw some signs of recovery in the demand for money**. Private sector deposits show a modest increase over recent months and most deposits recently liberalized from the *corralón* have been re-deposited in the banking system.[4] The authorities concurred with staff, however, that the best course was to continue the current cautious monetary program in order to anchor inflation expectations, particularly given the uncertainties of the pre-election period (SMEP, paragraph 8).

8. **President Duhalde has announced his desire to lift the *corralón* before leaving office in May**. Staff expressed strong concern that this was a risky strategy in that it could lead to pressures on weaker and less liquid banks, which would need to turn to the central bank for assistance. The staff advised that the voluntary process of deposit liberalization—with supervisors continuing to check the adequacy of each bank's liquidity position—should continue, but that the authorities should not take action to force the process.

9. **Adding to the uncertainties, the supreme court recently ruled that the *pesoization* of the deposits of a provincial government in one of the state banks was unconstitutional.** The court has given the parties 60 days to determine the modalities under which the redollarization would occur, thereby effectively postponing the decision until the next government takes office. A likely implication of the supreme court ruling is an acceleration of deposits released through *amparos*, which declined in January–February because of judicial holidays.

10. **The further liberalization of exchange controls (SMEP, paragraph 9) did not extend to the export receipts surrender requirement,** which the authorities prefer to maintain until financial stability is more entrenched. In addition to remaining capital controls, there are two unapproved Article VIII restrictions stemming from the freeze on time deposits and the prior approval required on loan amortization payments.

D. Structural Reforms

11. **Implementation of the banking strategy has been further delayed** (SMEP, paragraph 13). Reflecting a lack of political consensus, public bank reform is now expected to begin with only one of the three main banks, the other two (owned, respectively, by the province and city of Buenos Aires, and not under the control of federal government)[5] continue to resist the initial step of being subject to diagnostic review. Another difficult area

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[4] By early March, 25 banks had offered to liberalize in advance Arg$4.9 billion of reprogrammed deposits (about 26 percent of the total of such deposits).

[5] All three public banks are, however, under the supervision of the central bank.

is in defining a mechanism to compensate banks for the adverse impact of asymmetric indexation and *amparos*. This mechanism is to be agreed by end-March, but the government has not yet specified a precise date for the compensation to be implemented. Within the central bank, intensive work is ongoing to move away from the current situation of regulatory forbearance for banks. Largely for technical reasons,[6] the expected revision of prudential regulations has been delayed to end-March (SMEP, paragraph 13).

12. **Out-of-court workout legislation has also been delayed**. Draft legislation was expected to be submitted to congress in March. However, a consensus has been difficult to achieve. Bankers (as well as Fund staff) believe that the latest version of this draft legislation would once again significantly infringe creditors' rights by introducing a stay on court proceedings at the request of a minority of unsecured creditors. Staff advised that the legislation be radically amended before submission to congress or it would risk breaching a continuous performance criterion. The staff emphasized that the authorities should also ensure that mediation procedures for small- and medium-size companies introduced in January were kept on a fully voluntary basis and not be used to delay any court proceedings (SMEP, paragraph 19 and 20).

13. **Recent utility price increases have been rolled back**. The presidential decree issued on February 1, 2003, raising utility tariffs for electricity and gas by an average of 7–9 percent was overturned by a court ruling on February 25. The government is appealing against this ruling. A joint World Bank-Fund mission on utilities has sent a draft report and recommendations to the government for comments (SMEP, paragraph 11).

14. **An advisor on public debt restructuring has been appointed**. On February 26, the government appointed Lazard Frères as advisor on debt restructuring. An action plan is to be agreed with the advisor over the next few weeks; in the meantime, the dialogue with creditors is to be strengthened through such steps as: upgrading the investor relations website; planned meetings with creditors; soliciting views from creditors on appropriate negotiation structures, and their preferences for restructured instruments; and the preparation of a creditor database (SMEP, paragraph 17).

15. **A start has been made on preparing fiscal structural measures**. A FAD tax policy mission visited Buenos Aires in February and left a preliminary report with the government. A further mission will work with the authorities on intergovernmental relations in March (SMEP, paragraph 16).

IV. Staff Appraisal

16. **At the first review, the transitional program is broadly on track**. Quantitative program targets for January were met comfortably, but several expected structural reforms have been delayed. While the economy is experiencing a modest recovery and inflation is

[6] The new management at the central bank has indicated that it needs more time to expand the scope of the regulations (SMEP, paragraph 13).

subdued, export performance continues to disappoint and the financial sector remains dormant. The depth of the crisis is underscored by the fact that almost 50 percent of the population still live below the poverty line.

17. **Though fiscal performance in January was encouraging, major challenges lie ahead**. While the fiscal program is on track, there are still risks to revenues and expenditures from possible judicial decisions, and the fiscal program may need to be adapted for changes in the macroeconomic framework. Also, it will be a major challenge to enforce expenditure control at all levels of government given that presidential, gubernatorial, and congressional elections are all scheduled this year. It is a welcome sign that the provincial government financial results for 2002 were better than anticipated and that a significant number of provincial governors have already signed the bilateral agreements for 2003. As financing of the federal government is highly dependent on disbursements of the IFIs, it will be essential for financing flows from the MDBs to be restored to program levels in the coming months. Staff are encouraged by the authorities' statement that they will work together with the IFIs on an urgent basis to address the shortfall.

18. **Monetary policy continues to face significant uncertainties**. While the early liberalization of time deposits has not led to any substantial deposit leakage, the authorities should continue with the cautious approach incorporated in the monetary program and guard against premature deposit liberalization in banks with limited liquidity. A decision to prematurely lift the *corralón*, particularly in the context of increased market sensitivity ahead of elections, could place significant pressure also on the central bank. The fragility of the situation is underscored by the recent supreme court decision on the unconstitutionality of *pesoization*, which significantly adds to these uncertainties. We remain in close touch with the authorities on this issue; they have 60 days to formulate their response and believe that a final decision may eventually be taken only by the successor government.

19. **As the presidential election approaches, the policy-making environment is becoming more difficult**. The limited structural component of the program has, as anticipated, encountered implementation difficulties, particularly in sensitive areas such as public banks and private debt restructuring. In this latter area, the authorities need to make all efforts to ensure legal certainty and protect creditor rights.

20. **Priority needs to be given to providing a predictable regulatory framework for the banking system**. Revisions to prudential regulations are critical to producing meaningful bank statements and moving the strategy forward. Staff urge that these regulations be issued by the new end-March deadline. Also important is to expedite passage of the amendments to the financial institutions law that facilitate bank resolution, and measures to strengthen central bank autonomy.

21. **Policy preparation can facilitate the transition to the new government**. Now that a public debt advisor has been appointed, it is hoped that the sovereign debt restructuring process can move smoothly ahead. In the time remaining for the current government, relations with external creditors can be strengthened and progress made in technical work such as developing a database and a menu of options for restructuring. The authorities should

also work toward preparing draft legislation on tax reforms and intergovernmental relations that can be presented to the successor government.

22. **Following further discussions with the central bank, staff recommends approval of the Article VIII restriction arising from the *corralón*** based on the staff's updated assessment. The restriction was imposed for balance of payments reasons, does not discriminate among Fund members, and is temporary (given that there is a timetable for the release of the deposits).

23. **Staff recommends completion of the review, including of financial assurances**. While there were, as anticipated, slippages in the implementation of structural reforms, the authorities did well in both the fiscal and monetary areas to meet the quantitative targets for end-January. Given the selection of a debt advisor and the planned meetings with creditors, the staff also consider the "good faith" criterion of the lending into arrears policy to be satisfied. On this basis, the staff would support a waiver for nonobservance of the structural performance criterion on issuance of new banking regulations, and support completion of the first review under the Stand-By Arrangement

Table 1. Argentina: Quantitative Program Targets and Outcome, January-June 2003 1/

(In millions of Arg$, unless otherwise indicated)

	End-January					
	Performance Criterion			Performance Criteria		
	Target	Adjusted 1/	Actual	End-Mar.	End-May	End-Jun.
A. Fiscal Targets						
1. Cumulative primary balance of the federal government (floor)	424	424	855	1,500	3,310	4,500
2. Cumulative overall cash balance of the federal government 2/	18	18	498	-2,307	-2,708	-2,198
3. Federal government debt stock (ceiling)	515,000	451,815	450,586	576,000	603,000	612,000
4. Cumulative overall balance of the provincial governments 2/	...	...	...	-350	...	-712
5. Consolidated public sector debt stock (ceiling) 3/	583,000	516,331	514,841	613,000	640,000	650,000
B. Monetary Targets						
6. Stock of net international reserves of the central bank (in US$ millions) (floor)	-3,900	-5,432	-4,276	-3,900	-3,900	-3,900
7. Stock of adjusted monetary base 2/	37,250	37,250	36,813	37,650	37,200	36,400
8. Stock of net domestic assets of the central bank (ceiling)	52,265	58,165	53,275	52,665	52,215	51,415

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

2/ Indicative targets throughout the program period.

Table 2. Argentina: Federal Government Operations, 1999-2003

	1999	2000	2001	2002	Jan. 2003 Actual	Jan. 2003 Program	Proj. 2003
		(In millions of Arg$)					
Revenue	**55,020**	**55,813**	**50,389**	**56,401**	**6,003**	**5,606**	**76,771**
Tax revenue	38,626	40,672	37,164	41,714	4,550	4,156	59,795
Social security contributions	10,892	10,684	9,639	9,728	1,154	1,126	11,708
Other revenues 1/	5,503	4,456	3,586	4,959	299	324	5,267
Non interest expenditure	**53,952**	**53,130**	**50,210**	**54,165**	**5,148**	**5,182**	**66,748**
Wages	8,548	8,440	7,824	8,042	743	712	10,022
Goods and services	2,637	2,268	2,216	2,790	246	288	3,625
Transfers to the private sector	23,847	23,605	22,435	25,479	2,508	2,523	28,966
Transfers to provincial governments	17,844	18,041	16,987	17,182	1,581	1484.7	20,922
Other	1,075	776	748	672	70	174	3,214
Primary balance	**1,068**	**2,683**	**179**	**2,236**	**855**	**424**	**10,022**
Interest 2/	8,224	9,656	12,021	33,603	834	4,506	58,744
Overall balance	**-7,156**	**-6,974**	**-11,842**	**-32,287**	**21**	**-4,082**	**-48,722**
Interest capitalization 3/	0	0	1,429	27,075	360	4,100	46,935
Overall cash balance	**-7,156**	**-6,974**	**-10,413**	**-5,212**	**381**	**18**	**-1,787**
Memorandum items:							
Other debt creating expenditures 4/	1,861	1,569	1,552	38,100	104	5,772	16,700
Of which : bonds issued to assist banks	0	0	0	36,000	0	0	9,000
Interest arrears	0	0	0	12,833	973	1,050	17,291
Augmented primary balance	**-793**	**1,114**	**-1,373**	**-35,864**	**751**	**-5,348**	**-6,678**
Augmented overall balance	**-9,017**	**-8,543**	**-13,394**	**-83,220**	**-1,056**	**-10,904**	**-82,713**
		(In percent of GDP)					
Revenue	**19.4**	**19.6**	**18.7**	**17.8**	...	...	**15.7**
Tax revenue	13.6	14.3	13.8	13.2	...	...	12.2
Social security contributions	3.8	3.7	3.6	3.1	...	...	2.4
Other revenues 1/	1.9	1.6	1.3	1.6	...	...	1.1
Non interest expenditure	**19.0**	**18.6**	**18.6**	**17.1**	...	...	**13.6**
Wages	3.0	3.0	2.9	2.5	...	...	2.0
Goods and services	0.9	0.8	0.8	0.9	...	...	0.7
Transfers to the private sector	8.4	8.3	8.3	8.0	...	...	5.9
Transfers to provincial governments	6.3	6.3	6.3	5.4	...	...	4.3
Other	0.4	0.3	0.3	0.2	...	...	0.7
Primary balance	**0.4**	**0.9**	**0.1**	**0.7**	...	...	**2.1**
Interest 2/	2.9	3.4	5.0	10.6	...	...	12.0
Overall balance	**-2.5**	**-2.4**	**-4.4**	**-10.2**	...	...	**-9.9**
Interest capitalization 3/	0.0	0.0	0.5	8.5	...	...	9.6
Overall cash balance	**-2.5**	**-2.4**	**-3.9**	**-1.6**	...	...	**-0.4**
Memorandum items:							
Other debt creating expenditures 4/	0.7	0.6	0.6	12.0	...	...	3.4
Of which : bonds issued to assist banks	0.0	0.0	0.0	11.4	...	...	1.8
Interest arrears	0.0	0.0	0.0	4.0	...	...	3.5
Augmented primary balance	-0.3	0.4	-0.5	-11.3	...	...	-1.4
Augmented overall balance	-3.2	-3.0	-5.0	-26.3	...	...	-16.9

Source: Ministry of the Economy and Staff estimates.

1/ Includes central bank profits.

2/ In 2002-03, excludes interest due on unrestructured debt (phase two).

3/ Reflects the indexation of government bonds and interest capitalization associated with the phase one debt exchange in 2001.

4/ Includes bonds issued to banks in connection with banking crisis, and the reinstatement of wage and pension cuts implemented in July 2001.

Table 3. Argentina: Summary Operations of the Financial System, 1998-2003 1/

(In millions of pesos, end of period)

					2003	
	1999	2000	2001	Est. 2002	Jan. Actual	Jun. Program
	I. Central Bank					
Net international reserves	22,864	21,872	456	-11,736	-17,591	-17,251
Net domestic assets	4,647	4,525	17,680	40,887	47,083	46,150
Credit public sector 2/	6,869	6,614	15,375	51,021	54,691	52,569
Credit to the financial sector	1,856	1,083	10,124	24,446	24,151	24,446
Official capital and surplus and unclassified assets (net)	-4,079	-3,172	-7,820	-34,580	-31,759	-30,865
Monetary liabilities 3/	27,511	26,398	18,135	29,151	29,492	28,899
Currency issued	16,493	15,054	10,960	18,802	18,584	18,003
Reserve deposits of banks	10,083	9,575	6,809	10,349	10,908	10,896
	II. Banks and Non-Bank Financial Institutions					
Net foreign assets	-8,184	-6,622	-9,346	...	...	...
Net claims on Central Bank	10,999	10,993	-1,429	...	...	...
Net domestic assets	66,567	68,774	70,452	...	...	...
Credit to public sector (net)	13,400	18,414	23,747	...	...	...
Credit to private sector	70,578	67,910	55,979	43,777	43,669	45,747
Capital and reserves	-16,905	-17,283	-16,483	...	...	...
Other	-506	-267	7,208	...	...	...
Private sector deposits	69,383	73,145	59,677	64,136	64,880	65,811
Local currency	26,445	25,773	15,688	62,695	63,134	64,262
Foreign currency	42,938	47,372	43,989	1,441	1,746	1,549
	III. Consolidated Financial System					
Net foreign assets	14,681	15,251	-8,890	...	...	...
Net domestic assets	68,423	70,447	77,640	...	...	...
Credit to public sector (net)	20,269	25,028	39,122	...	...	...
Credit private sector	70,578	67,910	55,979	43,777	43,669	45,747
Net capital, reserves, and other assets	-22,425	-22,490	-17,461	...	...	...
Liabilities to private sector	83,104	85,698	68,750	80,497	81,192	83,809
Currency in circulation	13,721	12,553	9,073	16,361	16,312	17,997
Local currency deposits	26,445	25,773	15,688	62,695	63,134	64,262
Foreign currency deposits	42,938	47,372	43,989	1,441	1,746	1,549
	(In percent of GDP)					
Liabilities to the private sector	27.4	29.7	29.3	22.0	...	16.9
Currency in circulation	4.0	4.1	3.8	3.8	...	3.6
Peso deposits	9.1	9.4	8.1	11.6	...	13.0
Foreign currency deposits	14.3	16.3	17.4	6.7	...	0.3
	(In percent)					
Memorandum items:						
Risk-based capital-asset ratio (capital over risk-weighted assets) 4/	21.0	20.1	20.8	...	...	...
Share of nonperforming loans in total loans 5/	11.5	12.9	12.3	...	...	...
Share of foreign currency loans in total lending	66.3	68.7	72.1	...	...	...
Share of foreign currency deposits in total deposits	58.5	61.8	76.6	...	...	...

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

1/ Includes net use of IFI resources. For 2003, foreign currency items are valued at the program accounting rate of Arg$3.85 per U.S. dollar.

2/ For 2003, excludes on-lending of IMF disbursements. For 2002, reflects use of a special SRF deposit at the central bank and data discontinuity/reclassification related to the end of the convertibility.

3/ Does not include quasi-monies (equivalent to Arg$7,500 million at end-December 2002).

4/ For September 2001.

5/ Excludes unrecoverable loans that have been charged-off from assets on balance sheet.

Table 4. Argentina: Selected Economic and Financial Indicators, 1998-2003

	1998	1999	2000	2001	Est. 2002	Proj. 2003
	(Annual percentage changes; unless otherwise indicated)					
National income and prices						
GDP at constant prices	3.8	-3.4	-0.8	-4.4	-11.0	2-3
Consumer prices (average)	0.9	-1.2	-0.9	-1.1	25.9	34.6
Consumer prices (end-of-period)	0.7	-1.8	-0.7	-1.5	41.0	35.0
External sector						
Exports, f.o.b. (in terms of U.S. dollars)	1.0	-12.6	13.2	0.9	0.2	1.6
Imports, c.i.f. (in terms of U.S. dollars)	3.1	-18.7	-1.2	-19.5	-55.1	6.4
Export volume	11.6	-0.7	2.8	4.5	4.3	2.9
Import volume	8.7	-13.8	-1.2	-16.8	-55.8	4.4
Terms of trade (deterioration -)	-5.5	-5.9	10.2	-0.6	-1.1	-7.5
Real effective exchange rate						
Average (depreciation -)	3.5	12.4	-0.7	6.0	-57.3	...
Year-end (depreciation -)	0.3	12.6	1.7	2.9	-54.7	...
Money and credit 1/						
Financial system						
Net domestic assets	26.3	17.6	1.8	23.7	-36.3	0.7
Of which: credit to private sector	13.0	-2.0	-3.8	-9.2	-73.9	-1.1
Broad Liquidity (M3)	17.1	6.9	7.5	-12.1	-58.4	2.9
Income velocity of broad liquidity (M3)	1.7	1.4	1.3	1.3	2.3	4.8
Interest rate (30-day deposit rate, in percent) 2/	7.6	8.0	8.3	16.2	41.8	...
	(In percent of GDP)					
Public sector savings	-0.5	-2.6	-2.2	-4.7	-2.0	-1.7
Federal government primary balance	0.9	0.4	0.9	0.1	0.7	2.1
Federal government overall balance	-1.3	-2.5	-2.5	-4.4	-10.2	-10.1
Consolidated public sector primary balance	0.6	-0.7	0.4	-1.4	0.3	2.5
Consolidated public sector overall balance	-2.0	-4.1	-3.6	-6.8	-9.9	-10.2
Gross domestic investment	19.9	18.0	16.2	14.2	10.7	10.9
Gross national savings	15.2	13.8	13.1	12.5	18.9	16.3
Current account deficit	-4.8	-4.2	-3.1	-1.7	8.2	5.3
Public sector external debt (end-of-year)	27.8	29.9	29.7	32.8	83.6	75.3
	(In percent of exports of goods and nonfactor services; unless otherwise indicated)					
Public sector debt service	38.0	49.6	54.8	65.7	47.4	57.2
Of which: interest payments	17.5	22.4	21.7	21.0	22.4	23.2
Outstanding use of Fund resources						
(in percent of quota at end-of-period)	251.5	154.1	183.2	525.3	498.2	...
Gross foreign exchange reserves 3/	8.2	10.1	9.8	6.6	8.6	...

Sources: Ministry of Economy; and Fund staff estimates.

1/ December 2002 are estimates, based on June 2002 data. Foreign currency items valued at the program exchange rate of Arg$3.85 per U.S. dollar.
2/ Average interest rate on 30- to 60-day time deposits in national currency. The rate is weighted by deposit amounts.
3/ In months of imports of goods and nonfactor services.

Table 5. Argentina: Net Debt Service to the IFIs, January-August 2003

	Jan.-Feb.		Mar.-Aug.		Jan.-Aug. 1/	
	Program	Actual	Orginal	Revised	Orginal	Revised
IMF						
A. Debt service	1,239	1,237	5,314	5,307	6,553	6,544
B. Disbursements and extension of repurchase expectations	989	989	5,564	5,564	6,553	6,553
C. Net debt service (A-B)	250	248	-250	-257	0	-9
World Bank						
A. Debt service	935	935	1,301	1,301	2,237	2,236
B. Disbursements	680	156	1,550	2,085	2,230	2,241
C. Net debt service (A-B)	255	779	-249	-784	7	-5
IDB						
A. Debt service	859	829	1,132	1,073	1,991	1,902
B. Disbursements	1,013	923	1,168	1,291	2,181	2,214
C. Net debt service (A-B)	-154	-94	-36	-218	-190	-312

Sources: IMF, World Bank, and IDB staff.

1/ The revised program reflects changes in charges and interest for each institution, revised projections of disbursements for the World Bank and IDB, and exchange rate changes in January-February.

Table 6. Argentina: Summary Balance of Payments, 1999-2003

	1999	2000	2001	Prel. 2002	Proj. 2003
(In millions of U.S. dollars)					
Current account	**-11,905**	**-8,884**	**-4,567**	**8,817**	**6,528**
Trade account	-2,217	1,167	6,348	17,580	17,359
Exports f.o.b.	23,322	26,412	26,659	26,706	27,073
Of which: petroleum (net)	2,245	3,946	3,731	3,686	3,738
Imports c.i.f.	-25,539	-25,245	-20,311	-9,126	-9,714
Services and transfers	-9,688	-10,051	-10,915	-8,763	-10,830
Of which : net interest payments	-5,855	-5,865	-7,264	-8,846	-8,944
Capital account	**13,943**	**7,920**	**-16,944**	**-25,167**	**-38,090**
Net public sector capital	10,638	8,107	-2,065	-305	-18,145
Direct investment	7,756	10,786	3,303	179	382
Other net private sector capital 1/	-4,452	-10,973	-18,183	-29,505	-23,484
Overall balance	**2,037**	**-963**	**-21,512**	**-16,349**	**-31,562**
Financing	**-2,037**	**963**	**21,512**	**16,349**	**31,562**
Net international reserves (increase -)	-2,037	963	21,512	3,859	709
Financing gap 2/	**0**	**0**	**0**	**0**	**30,853**
Arrears/rescheduling	0	0	0	12,490	13,849
(In percent of GDP, unless otherwise specified)					
Current account	**-4.2**	**-3.1**	**-1.7**	**8.2**	**5.3**
Trade account	-0.8	0.4	2.4	16.3	14.2
Exports	8.2	9.3	9.9	24.7	22.1
Of which: petroleum (net)	0.8	1.4	1.4	3.4	3.1
Imports	-9.0	-8.9	-7.5	-8.4	-7.9
External debt	**51.3**	**51.4**	**52.0**	**126.3**	**110.6**
Of which : public sector	29.9	29.7	32.8	83.7	75.4
Total external debt service ratio 3/	**100.7**	**105.1**	**109.5**	**103.3**	**126.3**
Of which : public sector debt	49.6	54.8	65.7	47.4	79.4
(Percent change)					
Exports	-12.6	13.2	0.9	0.2	1.6
Of which: petroleum (net)	15.8	67.4	-8.3	-8.1	1.8
Imports	-18.7	-1.2	-19.5	-55.1	6.4
Memorandum items:					
Net international reserves 4/	5.8	5.5	0.1	-1.1	-2.7
(in millions of U.S. dollars)	22,844	21,881	369	-3,490	-4,199
Total external debt (in millions of U.S. dollars)	145,289	146,339	140,298	136,623	132,986
LIBOR (6 months U.S. dollar deposits)	5.5	6.4	3.8	2.1	3.2

Sources: Ministry of Economy; and Fund staff estimates.

1/ Includes errors and omissions.

2/ Includes arrears accumulation on debt to the private sector.

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

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

Table 7. Argentina: External Financing Requirements 2001-03

(In millions of U.S. dollars)

		Prel.	Proj.		
	2001	2002	1H 2003	Jan-Aug 2003	2003
Requirements	**48,536**	**21,161**	**16,321**	**21,168**	**34,903**
Current account deficit	4,459	-9,171	-3,465	-4,704	-6,527
Of which: net interest payments	7,379	6,969	3,302	4,500	7,111
Trade of goods and NFS	3,511	15,837	7,811	10,597	15,727
Capital outflows	44,077	30,332	19,786	25,873	41,431
Scheduled public sector amortization	16,544	8,875	7,946	12,045	18,145
Multilateral loans 1/	2,050	4,301	6,713	8,088	11,015
Of which IMF	1,185	737	4,798	5,761	5,436
Bilateral loans	506	516	351	498	793
Bonds and notes	7,137	3,752	2,551	3,710	6,029
Other	6,852	306	132	176	308
Private sector amortizations	17,761	10,793	5,429	6,876	9,824
Financial sector	783	2,079	1,855	2,116	2,644
Non-financial sector	16,977	8,714	3,574	4,759	7,179
Other private sector flows net (+ outflows) 2/	9,771	10,664	6,411	6,952	13,462
Sources	**48,536**	**21,161**	**7,311**	**21,168**	**29,732**
Capital inflows	36,524	16,724	6,533	9,354	15,030
Foreign direct investment	3,303	178	92	166	383
Disbursements to public sector	17,738	3,553	0	0	0
Private sector borrowing 3/	15,483	503	715	1,074	798
Exceptional financing	0	12,490	5,726	8,114	13,849
Public sector arrears accumulation 4/	0	8,314	4,172	6,027	10,694
Private sector arrears accumulation	0	4,176	1,555	2,087	3,156
Change in gross official reserves (- increase)	12,012	4,437	778	190	3,078
Program financing 5/	na	na	9,010	11,624	11,624
Of which: IMF	na	na	5,009	6,553	6,553
Financing gap	**na**	**na**	**0**	**0**	**5,171**

Sources: BCRA, and Fund staff estimates.

1/ Includes the clearance of arrears with the IDB and the World Bank.

2/ Includes errors and omissions

3/ For 2002 and 2003, includes mostly interbank credit and restructured debt.

4/ Excludes debt rescheduled by bilateral official lenders.

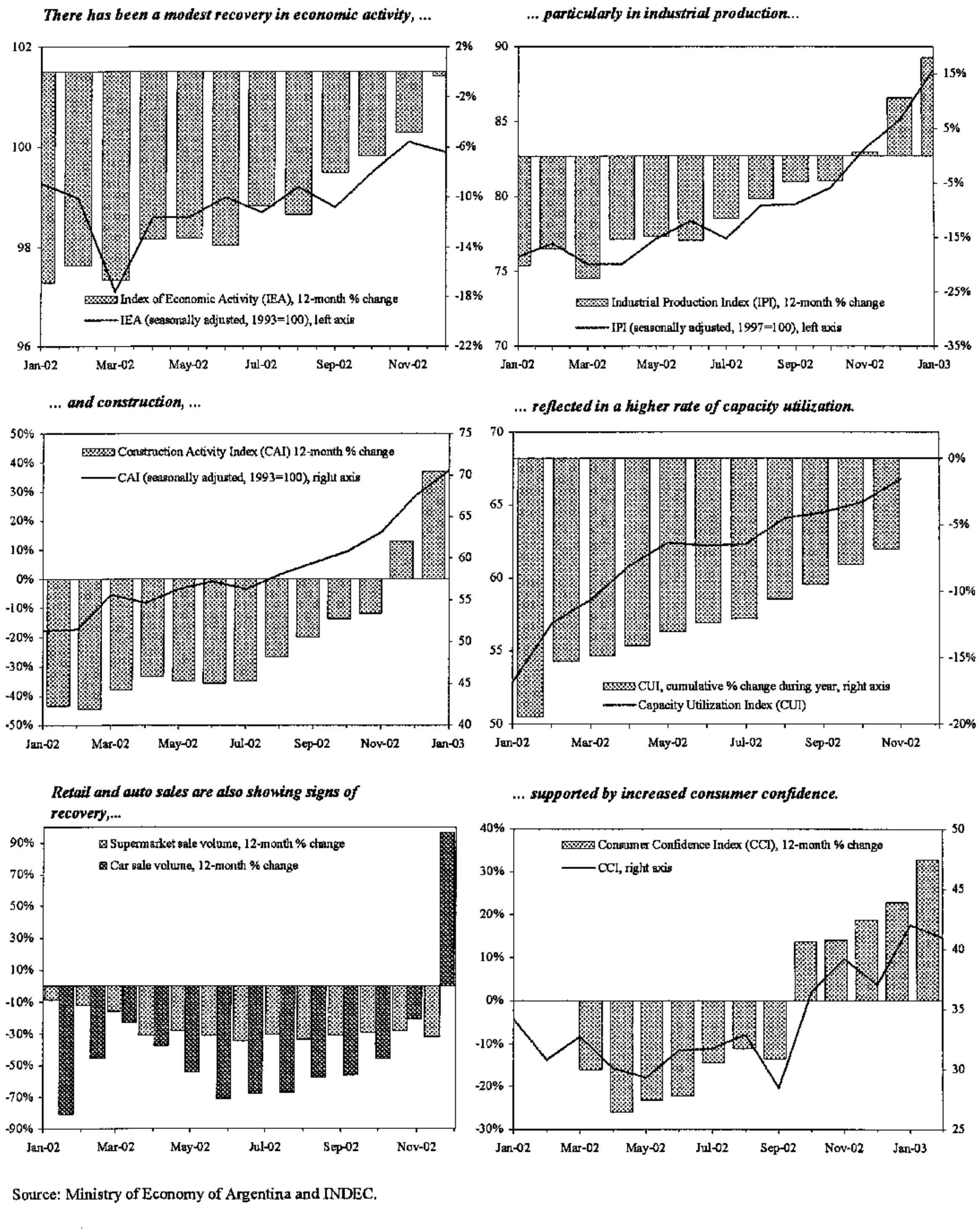
5/ Includes debt rescheduled by bilateral official lenders.

Table 8. Argentina: Schedule of Purchases Under the Stand-By Arrangement, January-August 2003

Date	Amount in millions of SDRs	In percent of quota	Conditions
January 28, 2003	747.0	35.3	Disbursed on Board approval
March 17, 2003	226.2	10.7	Observance of end-January 2003 performance criteria and completion of first review
May 15, 2003	226.2	10.7	Observance of end-March 2003 performance criteria and completion of second review
June 29, 2003	748.9	35.4	Observance of end-May 2003 performance criteria and completion of third review
August 15, 2003	226.2	10.7	Observance of end-June 2003 performance criteria
Total access 1/	**2174.5**	**102.7**	

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

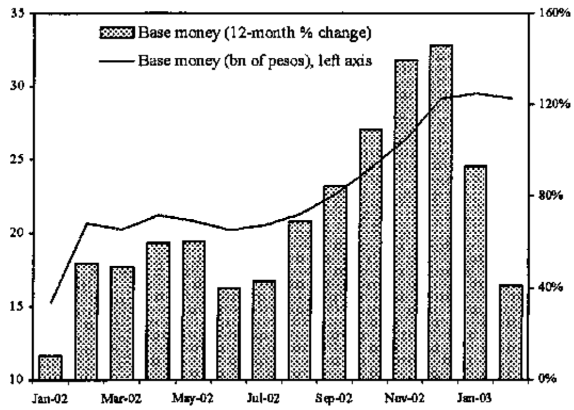
Figure 1. Argentina: Indicators of Real Activity



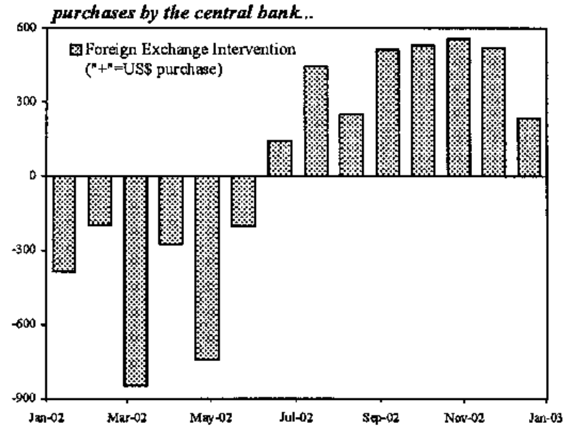
Source: Ministry of Economy of Argentina and INDEC.

Figure 2. Argentina: Recent Monetary Developments 1/

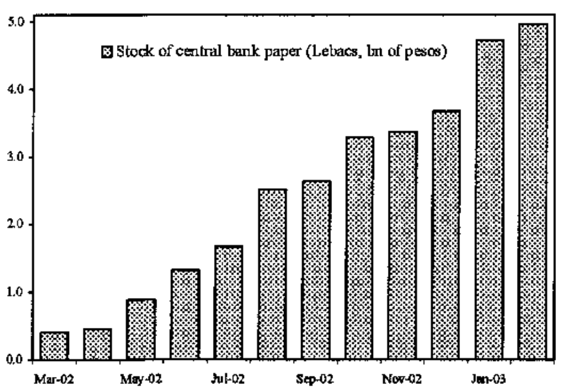
Growth of base money slowed in 2003...



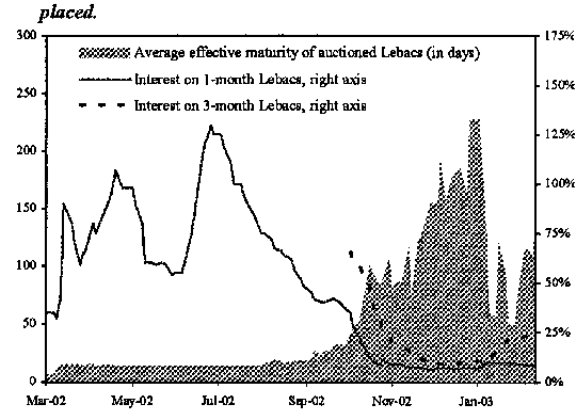
...in part as a result of reduced foreign exchange purchases by the central bank...



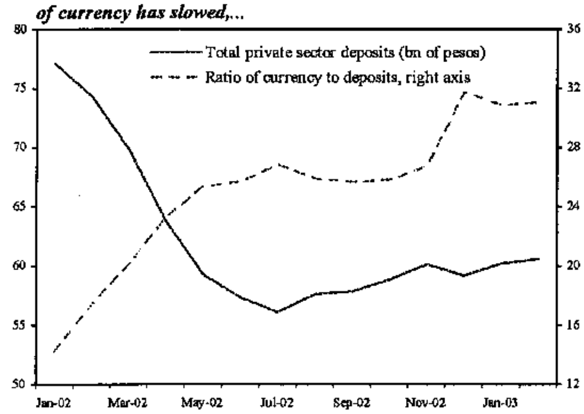
...and increased placements of central bank paper (Lebacs).



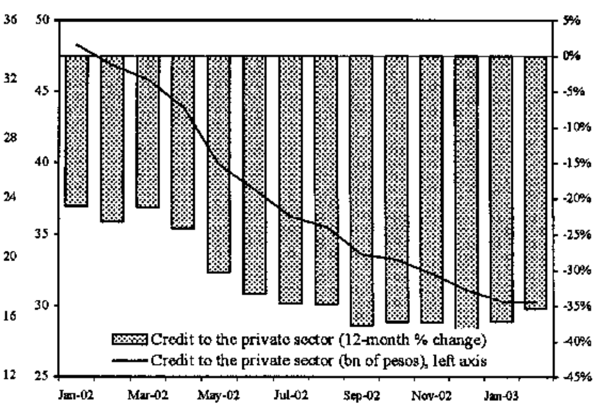
In recent auctions, only shorter-maturity Lebacs could be placed.



Meanwhile, deposits have remained relatively stable and growth of currency has slowed,...



...while credit to the private sector has continued to fall.

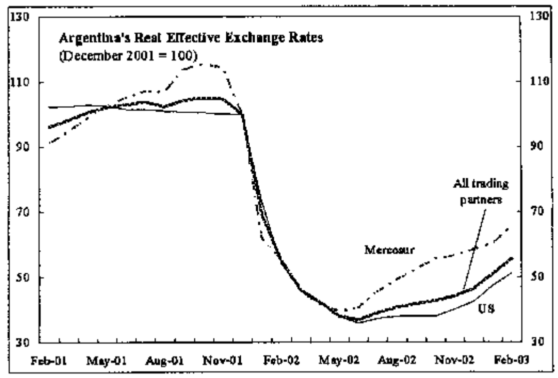


Source: Central Bank of Argentina.

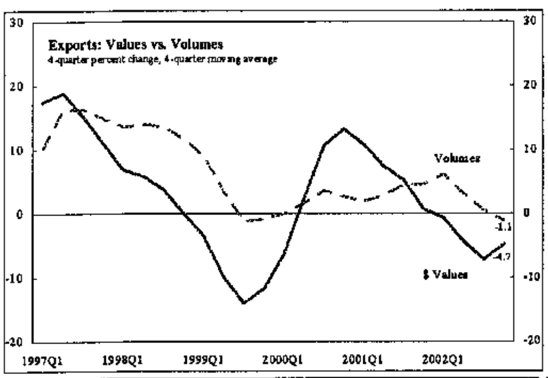
1/ Latest data points as of February 20-27.

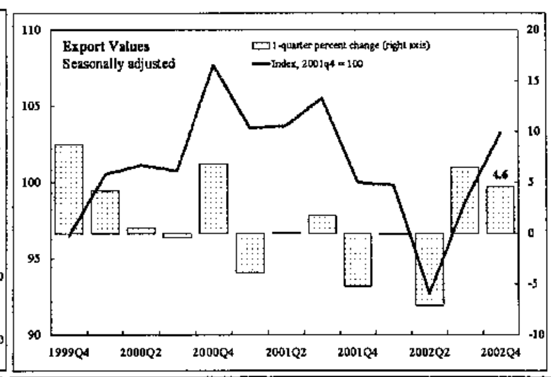
ARGENTINA—EXPORT PERFORMANCE AND COMPETITIVENESS

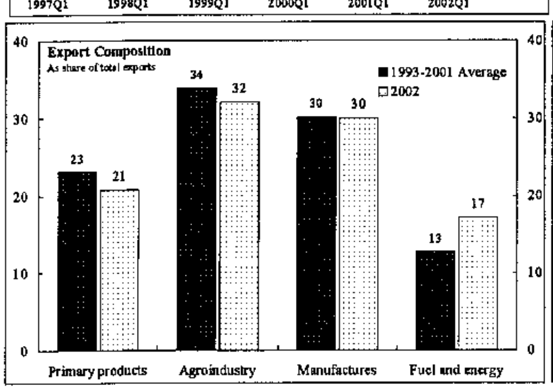
The peso has lost roughly half of its value in real effective terms since January 2002. The depreciation has been slightly less pronounced against the currencies of Mercosur (35 percent), and the Brazilian real, in particular. The exchange rate pass-through to wholesale prices has, so far, been limited (about 50 percent), potentially allowing for a significant gain in competitiveness. Exports of agricultural products—which use locally-produced fertilizers and gas—and fuels seem to be best placed to benefit from the depreciation. Industrial manufacturing exports would appear to face greater obstacles in the short term, given their higher import content and close correlation with the economic cycle of Brazil.

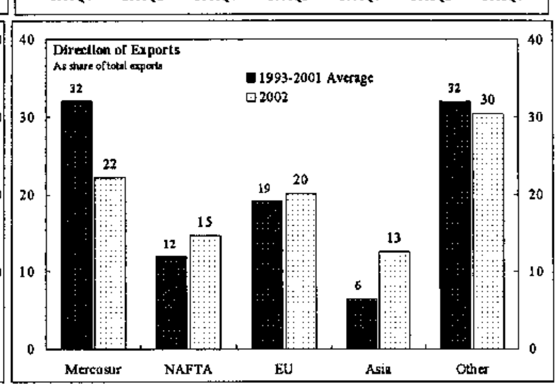


The response of exports so far has been weak. Although the current account shifted from a small deficit in 2001 to a surplus of about US$9 billion (or 8 percent of GDP) in 2002, this mainly reflected a sharp drop in imports. In 2002, exports contracted both in terms of value (-5 percent) and volume (-1 percent). The drop in exports was broad based, with agricultural manufacturing exports—which grew by 9 percent in value—the only significant exception. Export performance improved somewhat in the second half of 2002—growing by 5 percent on a seasonally adjusted basis, in part owing to a jump in oil export prices in the last quarter.









Export performance also has been weak compared to that in other countries that have experienced sharp devaluations. In the first year following the devaluation, export volumes in crisis countries grew on average by over 10 percent (Table I.A). Several factors could explain the weak response of Argentina's export sector so far: (i) a lack of bank credit because of the domestic banking crisis and loss of international credit lines; (ii) supply constraints related to the planting cycle of some agricultural products (for example, the planting season for soybean—which accounts for 20 percent of Argentina's exports—is in the first quarter of the year); (iii) weak economic growth in Brazil and other Latin American markets; (iv) the low degree of openness of the economy and small share of the traded goods sector (which could have slowed down the initial response to the change in relative prices); and (v) the export taxes, export receipts surrender requirements, and other controls on current and capital transactions introduced in 2001–02 that may have discouraged exports and/or resulted in the under invoicing of exports.

Table I.A. Export Performance in Countries Experiencing Large Devaluations

	Devaluation	Year After Devaluation	Export Volumes	Export Values	REER 1/	Real GDP	Foreign Activity 2/
	(Annual percent change in the year following devaluation)						
Mexico	1994, December	1995	12.1	24.3	-31.1	-6.2	2.7
Brazil	1998, December	1999	5.8	-7.8	-34.4	0.8	2.1
Indonesia	1997, August	1998	11.2	-11.8	-54.7	-13.1	0.2
Korea	1997, November	1998	13.2	-5.0	-28.2	-6.7	0.8
Thailand	1997, July	1998	6.5	-8.8	-19.3	-10.8	0.6
Turkey	1994, February	1994	15.2	15.4	-25.6	-4.7	1.5
Average			10.7	1.1	-32.2	-6.8	1.3
Argentina	2002, January	2002	-1.1	-4.7	-57.0	-11.0	1.5

1/ Real effective exchange rate.

2/ Trade-weighted real GDP growth in partner country.

ARGENTINA—POVERTY DEVELOPMENTS AND THE IMPACT OF THE CRISIS

The most recent data indicate that poverty rates and income inequalities increased further in the second half of 2002, despite the growth of employment support programs. The percentage of households living below the poverty line increased from 41.4 percent in May 2002 to 45.7 percent in October 2002, and the indigent population increased from 18 percent to 19½ percent. Although unemployment in the period fell from nearly 20 percent to 17.8 percent, this mainly reflected the growth of beneficiaries under employment support programs.

In 2002, direct social assistance doubled as a share of GDP to 1.2 percent. This was mainly achieved through the expansion of the government's flagship employment support program, the *heads of households* program, and the expansion of other pre-existing emergency programs. Financing constraints have also forced the government to implement a more fundamental reorientation of spending priorities towards the core social safety net programs, at the expense of less targeted social programs in the fields of health, education and social insurance, and to reduce real spending on pensions.

A recent study using Argentine household survey data found that households whose income fell most in the crisis had the following characteristics:[1]

- The households with the lowest incomes prior to the crisis also experienced the largest relative decline income during the crisis. In contrast, the wealthiest households prior to the crisis experienced the smallest declines in relative income.
- Households were particularly vulnerable if the head of household had few years of education. In general, the more years of education of the head of household the lesser the decline in household income during the crisis.
- Households in which the head was female generally experienced smaller declines in income than did households headed by males.
- Larger households suffered more than smaller ones, and households in which there was a high proportion of children and/or elderly were particularly vulnerable.
- Households in which the head was employed in the public sector experienced smaller income declines that those in which the head was employed in the private sector.
- Households where the head was employed in the private sector, but the household was located in a province with relatively high public spending experienced larger

[1] "Argentina: Macroeconomic Crisis and Household Vulnerability", draft IMF working Paper by Mmes. Inchauste, Corbacho and Garcia-Escribano.

income declines than those located in other provinces; this was particularly the case, when the higher provincial spending was on wages rather than investment.

These results generally lend support to the government's policy of relieving poverty by targeting cash transfers to low income households through the *heads of household* program. This program is a direct cash transfer of Arg$150 per month to unemployed heads of households with children under the age of 18 or handicapped members. Currently, about 1.8 million households receive support under the program, with a further 0.3 million who do not meet its eligibility requirements benefiting from a parallel employment program.

ARGENTINA—FUND RELATIONS

(As of January 31, 2003)

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

A. Financial Relations

II. General Resources Account:	**In millions SDRs**	**In percent of Quota**
Quota	2,117.10	100.00
Fund holdings of currency	12,610.86	595.67
Reserve position in Fund	0.02	0.00

III. SDR Department:	**In millions of SDRs**	**Percent of Allocation**
Net cumulative allocation	318.37	100.00
Holdings	751.97	236.19

IV. Outstanding Purchases and Loans:	**In millions of SDRs**	**In percent of Quota**
Stand-By Arrangements	9,762.33	461.12
Extended Fund arrangements	731.44	34.55

V. Latest Financial Arrangements

			SDR Millions	
Type	**Approval Date**	**Expiration Date**	**Amount Approved**	**Amount Drawn**
Stand-By	01/24/03	08/31/03	2,174.50	747.00
Stand-By	03/10/00	01/23/03	16,936.80	9,756.31
Of which: SRF	01/12/01	01/11/02	6,086.66	5,874.95
EFF	02/04/98	03/10/00	2,080.00	0.00

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

	Forthcoming				
	2003	**2004**	**2005**	**2006**	**2007**
Principal	3,988.75	4,971.15	1,045.65	394.85	93.38
Charges / interest	462.71	142.72	28.27	8.26	0.57
Total	4,451.46	5,113.86	1,073.92	403.11	93.94

VII. Safeguards Assessments: Under the Fund's safeguards assessment policy, the Central Bank of Argentina (CBA) is subject to an assessment with respect to the Stand-By Arrangement, which was approved on January 24, 2003 and is scheduled to expire on August 31, 2003. A safeguards assessment of the CBA was completed on September 05, 2002. The assessment concluded that: (i) substantial risks might exist in the system of internal controls, (ii) a more robust financial reporting framework should be developed, and (iii) the central bank's operational independence from government interference needs strengthening. Staff recommendations included publication of the 2001 financial statement and the strengthening of controls over the reporting of program data. The central bank has recently informed staff that these recommendations have been implemented. Other measures will be implemented as follows: (i) issuance of a resolution requiring the preparation of financial statements in accordance with International Accounting Standards (IAS), by March 31, 2003; and (ii) signing of memorandum of understandings between the central bank and the government, determining the conditions under which realized central bank profits are transferred to the government, by May 15, 2003. Staff will continue monitoring the implementation of the recommended measures.

B. Nonfinancial Relations

VIII. Exchange Rate: On March 27, 1991, a law was passed guaranteeing the full convertibility of the austral under a currency board arrangement and pegging the austral at ₳10,000 per U.S. dollar. On January 1, 1992 the peso was substituted for the austral at a rate of 1 peso per 10,000 australes. On January 7, 2002, the currency board arrangement was abandoned in favor of a dual exchange rate regime with an official rate of Arg$1.4 per U.S. dollar for most trade, trade finance, and public sector transactions; remaining transactions were at a market floating rate. On February 11, 2002, the dual exchange rate regime was abolished and substituted by a managed floating regime with no pre-announced rate of the exchange rate.

As of January 16, 2003, Argentina maintains two exchange restrictions that are subject to the Fund's jurisdiction under Article VIII, Section 2 (a): a restriction arising from the freeze on time deposits pursuant to the *corralón*, and a restriction arising from the prior approval requirement, which operates as a de facto prohibition, for moderate loan amortization payments.

IX. Last Article IV Consultation: The 2002 Article IV consultation was concluded by the Executive Board on January 8, 2003 (EBS/02/214).

X. Fourth Amendment: Argentina has accepted the Fourth Amendment to the Articles of Agreement.

XI. Technical Assistance, 2002

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

XII. Resident Representative: Mr. Luis Cubeddu has been the resident representative in Buenos Aires since September 2002.

ARGENTINA—RELATIONS WITH THE WORLD BANK GROUP[1]

Bank lending to Argentina as of December 31, 2002 totaled US$17.2 billion (net of cancellations). Thirty three loans totaling US$3.8 billion remain under execution, with about US$1.8 billion undisbursed. The Bank's assistance has focused on supporting Government efforts to: (i) enhance social development, including poverty alleviation and human resource development; (ii) improve performance and institutional capacity of sub-national governments to deliver key social and infrastructure services; and (iii) consolidate structural reforms, including reforms in public finances, labor markets and the financial sector to ensure successful implementation of the assistance program and enhance governance through institution building.

Out of the 33 ongoing loans, one of them is a Structural Adjustment Loan (SAL) for US$400 million—of which US$200 remain undisbursed. This loan was approved in August, 2001 as part of the joint IFI support to Argentina as the country began to slip deeper into the crisis at the end of 2000. In addition, three of the ongoing adjustment loans are Provincial Reform Loans (PRLs) totaling US$703 million—of which US$421 remain undisbursed. These loans, approved between September, 2000 and July, 2001 are part of a continuing effort to assist selected provinces—in this case Catamarca, Córdoba, and Santa Fe—willing and able to undertake structural reforms in the social sectors, and improve fiscal performance and financial management. These operations complement the adjustment operations to the Federal Government, addressing many of the same concerns such as social equity and systemic changes in health and education and on basic economic management. The remaining tranche releases for both the SAL and the PRLs are subject to a sound macroeconomic environment, as well as other specific conditionality in each case.

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

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

On November 14, 2002 Argentina announced it would be making only a partial payment on their October 15 obligation to the World Bank. As of that date, no new loans were presented to the Board of Directors, and Argentina lost its eligibility for reductions of interest charges

[1] Prepared by the staff of the World Bank on 1/14/03.

falling due over the following six months. Out of a payment obligation of US$805 million, Argentina made a US$79.2 million interest payment. On November 29, 2002 Argentina became 45 days overdue in its debt service payments to the Bank, and as of that date no replenishments or initial deposits to special accounts were made. Moreover, on December 9, 2002 the Bank notified co-financiers, namely Japan Bank for International Cooperation and Inter American Development Bank on the impending suspension of disbursements.

On December 13, 2002, Argentina failed to become current on all payments to the Bank, and consequently the Bank suspended, effective December 14, 2002, the borrower's rights to make withdrawals on all effective and not fully disbursed loans. Additionally, the Bank was not reimbursed for the payment made by the IBRD under its guarantee for the US$250 million Series D Zero Coupon Notes issued by the Republic of Argentina and due October 15, 2002, and consequently the guarantee is no longer eligible for reinstatement and transfer to the remaining Series E and F notes. As of December 31, 2002, Argentina was in arrears to the Bank for US$773.8 million.

Among the immediate consequences arising from the situation described above was the postponement of the presentation to the Board of Directors of an investment loan for US$600 million to finance the Heads of Household Project, in support of the Government's workfare program. This loan was originally scheduled for presentation to the Board of Directors of the Bank on November 19, 2002.

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

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

Financial Relations with the World Bank

(In millions of U.S. dollars)

	Commitments (Net of Calculations)	Disburse-ments	Undisbursed Amount
I. IBRD Operations (as of December 31, 2002)			
Fully disbursed loans	**13,377.6**	**13,377.9**	**0.0**
Loans in process of disbursement	**3,808.9**	**2,018.0**	**1,790.9**
A. Investment operations			
Social sector	666.3	436.1	230.2
Finance, infrastructure, and natural resources	1,749.2	876.2	873.0
Public administration	289.7	223.0	66.7
B. Adjustment operations	1,103.7	482.7	621.0
Total loans	**17,186.5**	**15,395.6**	**1,790.9**

II. IFC Operations (as of December 31, 2002)

	Loans	Equity	Quasi	Partici-pation
Held	690.5	196.3	208.1	899.6
Disbursed	660.0	139.6	208.1	879.6
Pending commitment	158.0	42.9	15.0	529.5

III. IBRD Loan Transactions

	Actuals (Calendar Year)					
	1997	1998	1999	2000	2001	2002
Disbursements	796.9	2,030.60	1,572.90	1,018.80	1,328.80	424.50
Debt service payments	299.1	350.20	445.00	538.10	675.50	1,869.80
Net transfers	497.8	1,680.40	1,127.90	480.70	653.20	-1,445.30

Source: World Bank.

1/ Includes repayment from third parties.

ARGENTINA—RELATIONS WITH THE IDB[1]

Portfolio

1. The Bank's activities had to be adjusted in light of this new economic context, so as to:

   - encompass harsher fiscal constraints;
   - protect social expenditure, deepening the actions undertaken with respect to reformulation of the social portfolio;
   - support development of the productive sectors through loans to the provinces under the new agreement with the federal government and support for small- and medium-sized enterprises (SMEs), particularly export-oriented SMEs, and support a review of the portfolio relating to the productive sectors; and
   - help maintain political reforms.

2. In March 2002, authorization was given to redirect US$694.2 million from low-performing operations of lesser priority in the context of the social and economic crisis now affecting the country to the Argentine government's Social Emergency Plan for social protection and containment programs, particularly food, medicines, and education.

3. In a second stage, work is underway on a proposal to redirect resources from active projects that are unlikely to make progress again soon to initiatives that help revitalize economic activity and improve the competitiveness of the productive sectors. This revitalization package could total US$800 million.

4. Disbursement of the second tranche of two sector loans is pending: the Financial Sector Program in the amount of US$243 million, and the Sector Program to Support the Federal Pact for Growth and Fiscal Discipline in the amount of US$246.7 million. In due course, a proposal will be submitted to the Board of Executive Directors to reformulate the conditionality of these operations to adapt them to the new reality in Argentina.

5. As of December 2, 2002 disbursements for the year totaled US$406.1 million, 72.3 percent of which were for the social sectors.

Operations Program

1. On February 5, 2003 an **emergency loan** of US$1.5 billion was approved to protect social expenditure. This operation will be disbursed in two tranches. Once the new

[1] Prepared by the Staff of the IDB.

government to be elected in the coming months has taken office, an additional emergency loan in the amount of US$1 billion could be approved, which could serve the social sectors as an instrument for policy dialogue with the new authorities.

2. Additionally, a financial sector loan is being considered for 2003; a loan for a group of comparatively less-developed provinces and direct loans to three provinces (Salta, Río Negro, and San Luis) that would help revitalize economic growth by supporting sectors with greater comparative advantages.

3. The operation relating to the comparatively less-developed provinces includes planning a long-term development strategy at the national and provincial level, with a view to identifying and strengthening sources of economic growth.

4. Moreover, technical cooperation operations are in preparation that aim to improve the competitiveness of small- and medium-sized enterprises and to strengthen the financial sector.

5. The Bank's new strategy for action in Argentina is expected to be approved by the end of 2003.

Buenos Aires, Argentina
March 3, 2003

Mr. Horst Köhler
Managing Director
International Monetary Fund

Dear Mr. Köhler,

1. The attached supplement to the Memorandum of Economic Policies (MEP) describes recent developments and policy implementation, and plans for the coming months, including additional steps to be taken by the Government of Argentina to strengthen the dialogue with private creditors. As described in the supplement, the quantitative performance criteria for end-January 2003 were met with considerable margins. We are confident that, by the time the Fund's Executive Board considers the first review of the arrangement, the structural performance criteria will have been met except for that related to revisions to banking regulations, which are being expanded to include a forward looking perspective. We request a waiver for this performance criterion, which we now expect to complete by end-March, 2003. In addition, we expect to complete the structural benchmark relating to public banks by the time of the second review of the program. Finally, we propose conversion into performance criteria of the end-May and end-June indicative targets on the cumulative primary balance of the federal government, stock of federal government debt, stock of the consolidated public sector debt, stock of net domestic assets of the central bank, and stock of net international reserves of the central bank.

2. To demonstrate our commitment to the continued timely honoring of the obligations that the Republic of Argentina has to the International Monetary Fund, we requested that amounts to be disbursed under the Stand-By Arrangement be held in the SDR account of the Republic of Argentina. However, the repurchases by the Government of Argentina ahead of approval of the arrangement resulted in an unintended accumulation in the SDR account of the Republic of Argentina. We therefore propose that the SDR account balance be reduced up to the amount of the first purchase under the arrangement. We confirm that all additional amounts disbursed under the arrangement should continue to be disbursed in SDRs and held in Argentina's SDR account, and that the Treasurer's Department of the International Monetary Fund is authorized to continue to debit the SDR account of the Republic of Argentina when future obligations of the Republic to the Fund become due.

3. During the remaining period of the arrangement, the government will continue to maintain a continuous dialogue with the Fund on the adoption of any measures that may be appropriate to achieve the objectives of the program. Reviews under the remaining period of the arrangement will be completed by May 15, 2003, and July 15, 2003. These reviews will continue to be associated with financing assurances reviews and to assess overall performance under the program, compliance with the IMF's Lending into Arrears Policy, and observance of the performance criteria for end-March and end-May, respectively.

Sincerely yours,

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

Attachment

SUPPLEMENT TO THE MEMORANDUM OF ECONOMIC POLICIES OF THE GOVERNMENT OF ARGENTINA FOR A TRANSITIONAL PROGRAM

I. INTRODUCTION

1. Progress has been made in implementing the transitional economic program which has been supported by a Stand-By Arrangement from the Fund since January this year. This supplemental memorandum of economic policies (SMEP) describes recent developments and policy implementation, and plans for the coming months. Except as modified in this memorandum, the objectives, policies, targets, and commitments of the transitional economic program remain as described in the original MEP dated January 16, 2003.

II. MACROECONOMIC POLICIES FOR 2003

A. Recent Developments

2. While it is only a month since the Stand-By Arrangement was approved—and thus too early to strengthen the program targets—there have been encouraging macroeconomic developments and the end-January quantitative performance criteria of the program were met with considerable margins. Based on recent industrial production data and other indicators of activity, we now expect real GDP to grow by about 3½ percent in 2003 (compared to 2–3 percent originally projected in the program). We also expect that inflation could be lower than the original objective of limiting price increases to below 35 percent in 2003. Our current goal is to keep inflation below 22 percent during calendar year 2003.

B. Fiscal Policy

3. The primary surplus of the federal government in January 2003 was Arg$855 million compared with Arg$424 million in the program, reflecting increased receipts from income tax. Spending on the social safety net was implemented as budgeted, with transfers to about 2.1 million recipients under the employment support programs. Fiscal performance is expected to be further strengthened by the conversion of the fuel tax to an ad-valorem basis, and the elimination of the income tax exemption on export rebates. These are expected to be approved by congress by March 14, 2003. We also expect, by mid-March, 2003, the elimination of the remaining competitiveness plans.[1] At this stage, the fiscal targets for the remainder of the program remain unchanged, but will be reassessed at the second review.

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[1] These measures are still being considered by the congress. At this stage, the conversion of the fuel tax to an ad-valorem basis has been approved by the lower house and is to be considered by the senate. The elimination of the income tax exemption on export rebates and the elimination of competitiveness plans were approved by the lower house, but the legislation was modified by the senate and thus needs to be sent to the lower house for final review.

4. The outturn for provincial government finances for 2002 was also better than expected, mainly reflecting improvements in own-tax revenues as a result of some recovery in economic activity and strengthened tax collection mechanisms. Thus, the provinces were broadly in primary balance in 2002 compared to the deficit of ½ percent of GDP that had been expected. By March 14, 2003, it is expected that the bilateral agreements for 2003 will have been signed by provincial governors representing at least 80 percent of the 2002 consolidated provincial deficit.[2]

5. The support of the international community is helping Argentina to address its financing difficulties in an orderly fashion. During the early part of this year, however, there has been a significant shortfall from the disbursements expected from the IFIs. Thus, during January–February, net debt service to the IFIs totaled more than US$0.5 billion. In the coming weeks, the Government of Argentina will work together with the IFIs to ensure that the shortfall is remedied on an urgent basis.

C. Monetary Policy

6. Meeting the monetary targets was facilitated by the better-than-expected fiscal position, the further liberalization of exchange controls and a more flexible exchange rate policy, which permitted reduced purchases of foreign exchange, and by substantially increased sales of central bank bonds (*lebacs*). The central bank was successful in increasing the size and depth of the market for *lebacs*, but there was reduced demand for longer-term *lebacs*, reflecting political uncertainties related to the forthcoming presidential election.

7. Since the beginning of the year, banks, in line with a ministry of economy resolution of June 2002, have voluntarily liberalized ahead of schedule about Arg$4.8 billion of the total of Arg$18 billion of reprogrammed time deposits, most of which have remained within the banking system. Hence, only 20 percent of deposits currently bear some restriction compared with almost all deposits a year ago. The central bank has allowed banks holding rediscounts to liberalize a portion of their time deposits on the condition that any liberalized deposits would be accompanied by repayment of an equivalent amount of rediscounts. As a result, banks have reduced rediscounts by about Arg$100 million. The superintendency of banks is carrying out liquidity assessments to ensure that weaker banks are not allowed to liberalize their deposits.

8. These developments have been encouraging in respect of a recovery in the demand for money. However, the central bank will continue to take a cautious approach, particularly ahead of the elections, and the monetary program will remain unchanged at this stage. It is expected that the voluntary process of liberalization will continue in the coming months. The monetary targets will be reassessed at the time of the second review.

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[2] At this stage, governors of provinces accounting for 72 percent of the 2002 deficit have signed bilateral agreements.

D. Exchange Controls

9. The authorities have continued to dismantle the exchange restrictions and controls introduced in 2002. In February 2003:

- Limits on banks' liquid foreign exchange position were raised from 8 percent to 10 percent of regulatory capital at end-November 2001.

- For a period of 60 days, nonfinancial private sector entities with unrestructured external obligations were allowed to make transfers to a U.S. dollar-denominated trust fund, in an amount no greater than 5 percent of the external debt in arrears, on the understanding that these funds will be used to cancel debt obligations once they have been restructured.

- Amortization payments on debts below US$1 million that were in arrears through end-2002 were permitted until end-March 2003.

- The limit on amortization payments falling due was increased from US$100,000 to US$300,000 per month per debtor.

10. A proposal to liberalize the remaining exchange controls and the export receipts surrender requirement will be made at the time of the second program review.

E. Privatized Utilities

11. In February 2003, a joint World Bank-IMF mission was invited to Buenos Aires to review progress in the renegotiation of public service concessions, assess the current legal and regulatory framework in which the renegotiation is being conducted, and to assess the key financial indicators of the concessionaires, the social impact of changes in tariffs, and the application of social tariffs. We note the main conclusions of this mission are:

- The determination of tariffs needs to shift from the present emergency renegotiation process to a predictable, and stable framework, supported by a firm legal basis. A common concern of stakeholders is that renegotiation is currently too focused on short-term adjustments, without a long-term framework.

- Urgent action toward renegotiation of long-term contracts is needed to avoid a deterioration of services and to fully restore investor confidence.

- There is a broad consensus among stakeholders about the importance of a "social tariff," not only as part of a strategy to exit the present crisis but also as an element that was missing from the long-term regulatory frameworks established in the early 1990s. Social tariffs need to be better designed within a fiscal neutral environment to improve their targeting to the most needy households.

12. On tariff increases, a further presidential decree (the third since September 2002) was issued on February 1, 2003 authorizing increases in utility tariffs for electricity and gas. The subsequent tariff increases, however, were again suspended following a court ruling on February 26, 2003. The government is appealing against this court ruling on the basis of differing interpretations of the scope of the Economic Emergency Law.

III. The Banking System

13. Several steps are being taken to implement reforms needed to restore the health of the banking system:

- We are continuing discussions with banks on mechanisms to compensate them for the adverse effects on their balance sheets of the asymmetric indexation of their assets and liabilities and the court injunctions (*amparos*). We expect to reach agreement and announce these mechanisms by end-March 2003.

- To clarify the basis for central bank liquidity support, the central bank issued regulations on *March 6, 2003*, ensuring that liquidity support will be provided on a uniform basis to all banks (public and private), ensuring that banks are not able to make new loans from future rediscounts, and introducing agreed supervisory triggers for banks relying excessively on such support. Penalty interest rates have been introduced on rollovers of the rediscount facility. We plan, ahead of the next review, to restructure the existing stock of rediscounts to match more closely bank interest expenses and interest revenues resulting from exposure to the public sector.

- The central bank continues to work on the technical details of new prudential regulations, which will be expanded to include a forward looking perspective. Thus, the revisions to norms for foreign exchange exposure, the valuation of government loans and bonds, and commercial loan classification requirements, will now be completed by end-March, 2003.

- More timely bank reporting has resumed, with the central bank now having received September 2002 financial statements from all commercial banks, although not on a uniform basis. The central bank also has received about 60 percent of financial statements for December 2002 and expects to receive the remainder by mid-March, 2003. Requests have been made for business plans/cash flow projections for 2003–04 and these are expected by April 15, 2003. On the basis of these reports, by May 15, 2003, the central bank will announce a minimum capital adequacy ratio for a transitional period and assess and classify banks.

- By March 14, 2003, the ministry of economy will submit to congress amendments to the financial institutions law that aim at strengthening the procedures for resolving problem banks. We expect congress to approve these amendments by the second program review.

- To strengthen the autonomy of the central bank, the ministry of economy will submit to congress by March 14, 2003, draft legislation aimed at allowing the central bank to appoint its own personnel, and giving budgetary independence to the central bank. We expect congress to approve this legislation by the second program review.

14. The initiation of public bank reform is now expected to begin before the second review of the arrangement. Negotiations are still under way both to obtain the full cooperation of two of the three public banks involved (the Board of Banco de la Nación has already approved the bidding terms) and support from the multilateral institutions. By the time of the next review, the bidding process will be launched for international accounting firms to conduct due diligence examinations, and for an international management consultant to advise on improved management practices, the preparation of business plans, and to carry out a strategic review of their operations.

IV. Safeguards Assessment

15. In regard to the safeguards assessment of the central bank, implementation of many of the Fund's recommendations is under way, and the following further actions are planned:

- By March 31, 2003, the central bank will issue a resolution requiring the preparation of financial statements in accordance with International Accounting Standards, with effect from the financial year ending December 31, 2003.

- By the third review, the central bank will enter into a memorandum of understanding with the government that determines the conditions under which realized central bank profits are transferred to the government.

V. Medium-Term Framework and Debt Restructuring

A. Fiscal Structural Reforms

16. A start has been made on the structural fiscal reforms at the federal and provincial levels that are needed to help strengthen the public finances to achieve sustainability. In February, with the help of technical assistance from the Fund, progress was made in identifying the key elements of a comprehensive reform of the tax system. A Fund mission will travel to Buenos Aires in March to assess possible reforms of intergovernmental relations. We expect draft legislation with respect to these reforms to be ready by the second program review and in time for early consideration by the incoming administration.

B. Public Debt Restructuring

17. The collaborative approach toward restructuring public debt held by private creditors has been strengthened by the appointment, on February 27, 2003, of an external advisor that will assist in managing relations with creditors and in preparations for debt-restructuring

negotiations. An action plan will be agreed with the advisor in the next few weeks. In the meantime, we are advancing our dialogue with creditors in a number of ways:

- Our investor relations website is being upgraded to include, e.g., messages to creditors, accounts of meetings held with creditors, the opportunity for creditors to submit comments and questions, and a template of information relevant to the restructuring.

- We are soliciting views from creditors on appropriate negotiation structures, the methodology for establishing claims, and their preferences for restructured instruments.

- A database is being prepared by type of creditor and magnitude of holdings.

18. In seeking to restructure our public debt, we remain committed to achieving an adequate degree of intercreditor equity and to ensuring that payments on restructured instruments will be consistent with the envelope of resources that, over the medium term, Argentina can generate and can reasonably expect to mobilize from private capital markets.

C. Private Debt Restructuring

19. An executive decree has been issued to facilitate voluntary mediation for individuals and small- and medium-sized companies. As indicated in the decree, the implementing regulations will ensure that the principles of voluntary mediation are upheld, including by ensuring that: (i) both parties need to agree before mediation is initiated; (ii) nonparticipation in the mediation procedures would not prejudice creditor rights; and (iii) the mediation procedure would not delay parallel court proceedings involving the enforcement of creditor rights.

20. Discussions with respect to the draft law on voluntary out-of-court workouts to facilitate corporate debt restructuring remain ongoing. We now hope to submit this legislation to congress by the time of the third review based on a consensus of all parties involved. The guiding principles of this legislation remain those outlined in the original MEP.

D. Anti-Money Laundering

21. Argentina has been active in the field of anti-money laundering (AML) and combating the financing of terrorism (CFT). As a member of the FATF, it has agreed to the new AML/CFT methodology. It has also communicated its request to participate in the ROSC program on these issues in the fourth quarter of 2003.

Box 1. Continuous and Structural Performance Criteria and Structural Benchmarks: Outcome for the First Review

	Status
I. Performance Criteria	
Continuous performance criteria	
• Nonaccumulation of arrears to bilateral and multilateral creditors.	Observed
• Nonissuance of quasi-monies by provincial governments that have signed the bilateral agreements.	Observed
• No statute or other legal instrument will be adopted that provides a means for any involuntary suspension of creditors' rights.	Observed
March 14,2003	
• Conversion of the fuel tax to an ad-valorem tax and elimination of the income tax exemption on export rebates.	Pending
• Revisions to banking regulations to strengthen the bank supervisory and prudential framework.	Waiver requested
• Signature of the 2003 bilateral agreements by governors of provinces representing a combined total of at least 80 percent of the 2002 consolidated provincial deficit.	Pending
II. Structural Benchmarks	
Continuous	
• Provide Fund staff with monthly information on provincial government financing with a delay of less than 55 days.	Not applicable
March 14, 2003	
• Appointment of an external advisor on public debt restructuring.	Observed
• Launch the bidding process for due diligence and strategic review of the public banks.	Delayed

Box 2. Continuous and Structural Performance Criteria and Structural Benchmarks for the Second Review

I. Performance Criteria

Continuous performance criteria

- Nonaccumulation of arrears to bilateral and multilateral creditors.
- Nonissuance of quasi-monies by provincial governments that have signed the bilateral agreements.
- No statute or other legal instrument will be adopted that provides a means for any involuntary suspension of creditors' rights.

March 31, 2003

- Elimination of the remaining competitiveness plans.

May 15, 2003

- Announce a transitional minimum capital adequacy ratio.
- Revisions to banking regulations to strengthen the bank supervisory and prudential framework.

II. Structural Benchmarks

Continuous

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

May 15, 2003

- Ratification by provincial legislatures of the 2003 bilateral agreements.
- Preparation of draft legislation for structural fiscal measures.
- Congressional approval of amendments to the financial institutions law.
- Launch the bidding process for due diligence and strategic review of the public banks.

TECHNICAL MEMORANDUM OF UNDERSTANDING

This memorandum presents a detailed definition of the variables included in the quantitative performance criteria and the structural performance criteria and benchmarks for the economic program described in the supplementary Memorandum of Economic Policies of the Government of Argentina to 2003.

I. FISCAL TARGETS

A. Federal Government

1. Performance criterion on the cumulative primary balance of the federal government

Cumulative Primary Balance of the Federal Government	Floor (in millions of Arg$)
End-March 2003 (performance criterion)	1,500
End-May 2003 (performance criterion)	3,310
End-June 2003 (performance criterion)	4,500

The primary balance of the federal government will cover government operations specified in the 2003 budget, and exclude privatization receipts and capital gains on the sale of financial assets. The primary balance of the federal government will be obtained from the accounts "*ahorro-inversión base caja*" published by the *Secretaría de Hacienda*. The primary balance of the federal government will incorporate transfers of realized central bank profits up to a maximum of Arg$575 million in the first half of 2003.

Debt recognition operations not accrued in previous budgets will be considered primary expenditure with the exception of those in points (i) to (iii) in item 3 below, and in point (iv) of item 3 up to the amounts specified therein.

These data will be provided to Fund staff by the *Secretaría de Hacienda* no later than 25 days after the test date.

2. Indicative target on the cumulative overall cash balance of the federal government

Cumulative Cash Balance of the Federal Government	Floor (in millions of Arg$)
End-March 2003	-2,307
End-May 2003	-2,708
End-June 2003	-2,198

The overall balance of the federal government comprises the results of the federal government and the quasi-fiscal balance of the central bank (BCRA). The coverage of the federal government is as specified in item 1 above. Interest excludes capitalization and arrears. The quasi-fiscal balance of the BCRA is defined as interest earnings on gross international reserves, plus interest on government bond holdings of the BCRA, plus net interest (cash) from domestic operations and minus profit transfers to the federal government.

Debt recognition operations will be treated as explained in item 1 above.

The overall balance of the federal government will be measured from below-the-line on the basis of: (i) the information provided by the public sector debt reporting system (SIGADE), including all short-term debt of the federal government; (ii) net asset transactions of the federal government as reported by the *Secretaría de Finanzas*, the *Dirección Nacional de Cuentas Internacionales* (DNCI) and the *Gerencia de Manejo de Reservas Internacionales* of the BCRA; and (iii) information on federal government net bank borrowing and bank deposits provided by the BCRA.

These data will be provided to Fund staff no later than 25 days after the test date.

3. **Performance criterion on the stock of federal government debt**

Federal Government Debt Stock	Ceiling (in billions of Arg$)
End-March 2003 (performance criterion)	576
End-May 2003 (performance criterion)	603
End-June 2003 (performance criterion)	612

The stock of debt corresponds to the definition of the federal government in the 2003 budget. The program debt stock targets incorporate, among other things, the operation of the budget, the effect of inflation on debt indexed to the CER, interest arrears and interest on principal arrears,[1] and the issuance of: (i) compensation bonds to the financial system;[2] (ii) debt issued in the *Canje II* deposit-bond exchange (Arg$2 billion, February and Arg$5 billion, May); (iii) provincial government bonds arising from the Phase 1 debt exchange and guaranteed by the federal government (Arg $34.2 billion, February); and (iv) debt recognition operations.[3]

[1] The latter accumulates at 2 percent plus CER for peso-denominated debt and three-month LIBOR for foreign currency denominated debt.

[2] These include: (a) the completion of the placement of the compensation bonds for asymmetric *pesoization* (Arg$7.8 billion, March); (b) compensation for asymmetric indexation of assets (Arg$3.8 billion, May); and (c) compensation for losses arising from judicial injunctions (Arg$5.1 billion, May).

[3] These include: (a) *Bocones* (Arg$2.1 billion plus CER, spread evenly January–August); (b) other debt recognition operations (Arg$5.6 billion plus CER, March).

The estimate of compensation bonds to the financial system will be revised at the time of the first program review.

For purposes of this performance criterion, the term "debt" has the meaning set forth in point No.9 of the Executive Board's Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), which includes loans, leases, and suppliers' credits. The term "debt" also includes all obligations guaranteed by the federal government and contingent liabilities arising from derivatives contracts. Only debt actually placed by the test date will be included. Debt denominated in foreign currency will be valued at the market exchange rates prevailing at the test date. The following adjustments to the targets will be made:

a. Upward (downward) for the increase (decrease) in the stock of debt due to deviation of the CER and foreign exchange rates relative to the assumptions in the program (see Section IV below).

b. Downward for any privatization proceeds, other asset sales, debt restructuring, by the amount of any debt retired due to "netting" operations involving write-down of central bank liquidity support against bank holdings of government debt, and by the amount of any debt retired under the *Canje I*, *Canje II*, *Cobertura* operation.

c. Upward (downward) by any increase (decrease) in the stock of debt resulting from deviations from the assumptions set out in points (i) to (iii) above.

d. Downward by any decrease in the stock of debt resulting from deviations from the assumptions set out in point (iv) above.

e. Upward by the net increase in the stock of debt arising from any reversion of guaranteed loans issued in the Phase 1 debt exchange to their underlying securities.

The data used to monitor debt developments will be taken from SIGADE, including all short-term federal government debt. These data will be provided to Fund staff by the *Secretaría de Finanzas* no later than 25 days after the test date.

B. Provincial Governments

4. **Indicative target on the cumulative balance of the provincial governments.**

Cumulative Provincial Government Balance	Floor (in millions of Arg$)
End-March 2003	-350
End-June 2003	-712

The balance of the provincial governments comprises the consolidated result of the provinces, including the city of Buenos Aires. The result of these jurisdictions will be measured from above-the-line, with expenditure defined on an accrual basis and including all spending that provincial governments pay with bonds (such as salaries paid with *Patacones*) and all interest on bonds issued by the province of Buenos Aires to recapitalize *Banco Provincia (BPBA)*, according to the information provided by the *Secretaría de Hacienda*. These limits will be indicative.

These data will be provided to Fund staff by the *Secretaría de Hacienda* no later than 25 days after the test date.

In addition, the *Secretaría de Hacienda* and the BCRA will provide the following data from below-the-line on the financing flows of the provinces no later than 55 days after the end of the test date. The data will comprise provincial government deposit changes including quasi-monies, issuance of provincial bonds, the issuance of any other form of provincial debt (including debt service arrears), privatization receipts and amortization of provincial debt. The provision of this information to Fund staff within the reporting period is a structural benchmark.

C. Consolidated Public Sector

5. **Performance criterion on the stock of debt of the Consolidated Public Sector (CPS).**

The Debt Stock of the CPS	Ceiling (in billions of Arg$)
End-March 2003 (performance criterion)	613
End-May 2003 (performance criterion)	640
End-June 2003 (performance criterion)	650

The stock of debt of the consolidated public sector includes the sum of the debt of the federal government as defined in item 3 above, that of the trust funds and PAMI, and that of the provincial governments,[4] and the city of Buenos Aires, net of intergovernmental debt. All the adjusters specified in item 3 above apply to these targets.

The provision of the data for the provinces, trust funds and PAMI is the responsibility of the *Secretaría de Hacienda*. These data will be provided to Fund staff no later than 25 days after the test date.

[4] Provincial debt excludes interest arrears on defaulted debt.

II. Monetary Targets

6. Performance criterion on net international reserves (NIR) of the BCRA

Net International Reserves	Floor (in millions of U.S. dollars)
End-March 2003 (performance criterion)	-3,900
End-May 2003 (performance criterion)	-3,900
End-June 2003 (performance criterion)	-3,900

NIR is defined as the difference between gross foreign reserves and liabilities to the IMF. Gross foreign reserves include the BCRA holdings of gold, SDRs, foreign currency in the form of cash, and deposits abroad, government securities of investment grade of OECD countries, and Argentina's net cash balances within the Latin American Trade Clearing System (ALADI). Liabilities to the IMF are valued at US$1.32408 per SDR. Gross and net international reserves will be evaluated at program exchange rates and be measured at the average value over the 10 working days preceding the test date and the 10 working days following the test date.

The NIR floor will be adjusted by the equivalent of net flows in foreign currency to the IFIs from January 1, 2003. The adjusted target will be measured on an average daily basis over the 10 working days preceding the test date and the 10 working days following the test date.

7. Indicative target on the adjusted monetary base of the BCRA

Adjusted Monetary Liabilities	Ceiling (In millions of Arg$)
End-March 2003	37,650
End-May 2003	37,200
End-June 2003	36,400

Adjusted monetary base of the BCRA comprises the monetary base and the stock of provincial and federal government quasi-monies issued. Monetary base is defined as the sum of currency issued and banking system peso deposits with the central bank. The stock of quasi-monies will be measured at face value at a value of 1:1 to the peso. The monetary base will be measured at the average value over the 10 working days preceding the test date and the 10 working days following the test date.

The adjusted monetary base target will be adjusted upward (downward) by the upward (downward) revision to the stock of provincial and federal quasi-monies as of December 31, 2002. The data on provincial and federal quasi-monies will be provided to Fund staff by the Ministry of Economy.

8. **Performance criterion on adjusted net domestic assets (NDA) of the BCRA**

Net Domestic Assets	Ceiling (in millions of Arg$)
End-March 2003 (performance criterion)	52,665
End-May 2003 (performance criterion)	52,215
End-June 2003 (performance criterion)	51,415

The adjusted net domestic assets (NDA) of the BCRA are defined as the difference between adjusted monetary base and net international reserves (NIR) of the BCRA.

The NDA ceiling will be adjusted by the equivalent of net flows in foreign currency from the IFIs from January 1, 2003.

III. Structural Performance Criteria and Benchmarks

9. Continuous performance criteria, structural performance criteria, and structural benchmarks under the program are detailed in Box 2 (Attachment II).

IV. Program Accounting Rates

	March 2003	May 2003	June 2003
Arg$/US$1 (e.o.p)	3.85	3.85	3.85
US$/SDR (e.o.p.)	1.32408	1.32408	1.32408
US$/Euro	1.02	1.02	1.02
US$/CAD$	1.58	1.58	1.58
US$/JPY	121.63	121.63	121.63
US$/CHF	1.48	1.48	1.48
US$/GBP	0.64	0.64	0.64
CER coefficient (e.o.p.)	1.59	1.68	1.73

Any variable that is mentioned herein for the purpose of monitoring a performance criterion or indicative target and that is not explicitly defined, is defined in accordance with the Fund's standard statistical methodology, such as the Government Financial Statistics. For variables that are omitted from the TMU but that are relevant for program targets, the authorities of Argentina shall consult with the staff on the appropriate treatment based on the Fund's standard statistical methodology and program purposes.

INTERNATIONAL MONETARY FUND

ARGENTINA

First Review Under the Stand-By Arrangement, Exchange System, and Request for Waiver of Nonobservance of Performance Criteria

Supplementary Information

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

Approved by John Dodsworth and G. Russell Kincaid

March 17, 2003

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I. INTRODUCTION

1. The following information on recent developments and policy implementation has become available since the circulation of the staff paper on the first review under the Stand-By Arrangement (EBS/03/32, March 10, 2003). There is no change in the staff appraisal.

II. RECENT DEVELOPMENTS

2. Recently released data generally confirm the trends presented in the staff paper:

- **Monthly inflation continues to be low**. Consumer prices rose by 0.6 percent and wholesale prices 0.4 percent in February, bringing down the 12-month increases to 36.1 percent and 84.1 percent, respectively.

- **The trade balance continues to be in large surplus**. The foreign trade surplus in January was US$1.3 billion compared to US$970 million in the same month of last year.

- **Market indicators remain broadly stable**. In March the *peso* has traded in the range of Arg$3.12–3.22 per U.S. dollar; interest rates have remained stable; the central bank has made net purchases of US$53 million in the foreign exchange market; and gross international reserves remain at about US$10.3 billion. Private sector bank deposits have increased by about Arg$1.6 billion (2.6 percent) since end-January.

- **February tax revenues were below projections**. Tax revenues in February were Arg$126 million (2½ percent) below program projections, partly offsetting the higher collections of January. Receipts from VAT, trade taxes, and social security contributions were lower than expected, though income tax receipts continued to perform strongly.

3. **On March 5, the supreme court ruled unconstitutional the *pesoization* of the deposits of a provincial government in a state bank**. The main points of the ruling are:

- The ruling is specific to the case of San Luis province and does not have an automatic effect on other cases. Other depositors will need to file their own cases, but judges would likely follow the lead of the supreme court.

- The ruling does not expressly require the redollarized deposit to be paid out immediately in cash, the implication being that a bond or an agreed payments schedule could be acceptable instruments of payment. The ruling places responsibility on the bank involved (in this case, Banco Nación) to negotiate the payment modality.

- The parties involved have been given 60 days to reach agreement on the modalities for repayment of the deposit. If agreement is not reached by then, the supreme court may decide the modalities for repayment upon request of one of the parties.

4. **The authorities believe that the ruling will not affect the present stability of bank deposits and the exchange rate**. They have indicated that the government will eventually need to compensate banks through the issuance of bonds covering the valuation loss on foreign exchange deposits arising from the difference between the current exchange rate and the Arg$1.4 per dollar plus price indexation (approximately Arg$2 per dollar) implicit in the deposits still within the *corralón* (the restriction on time deposits).

5. **However, the ruling has added to uncertainties and some market turbulence may arise in the coming weeks**. Much will depend upon further rulings.

- Further court decisions favoring other depositors could well lead to problems within the banks. (The supreme court may rule in a case involving a private depositor within the next few days.)

- An expected first implication is that the pace of court injunctions to release deposits (the *amparos*) will increase, which will further decapitalize banks and could lead to liquidity pressures.

- The ruling also brings into question the constitutionality of the *corralón*.

- There will likely be an increase in court cases dealing with the pesoization of loans and other bank assets. We understand that the ruling gives some implicit basis for banks to challenge the pesoization of loans in excess of US$100,000.

6. **An important implication for the banks is that they could be directly responsible for full payment to depositors and would need to provision for additional government bonds in their balance sheet once they are compensated**. The uncertainty for the banks already has been increased by the delay within the program of the action to specify a mechanism by which the banks would be compensated for losses from asymmetric indexation and *amparos*.[1]

7. **Estimates of the fiscal cost arising from the supreme court ruling depend upon the assumption concerning the scope of the decision**. If the deposits to be compensated are limited to those currently within the *corralón* (US$9 billion in original valuation), then the total cost would be about US$4 billion (about 3 percent of GDP).[2]

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[1] This action is now expected by end-March 2003; a date for implementation has not been fixed.

[2] The estimated cost of US$4 billion is calculated as the difference between: (i) total deposit liabilities originally denominated in U.S. dollars valued at the current exchange rate (Arg$31.4 billion); and (ii) the same liabilities valued at the *pesoized* rate of Arg$1.4 per U.S. dollar and indexed by inflation (Arg$19.6 billion).

III. Policy Implementation

8. **Progress has been made in the following areas**:

- The Congress approved legislation suspending the income tax exemption on export rebates until end-2003. At the same time, it is still deliberating the legislation converting the fuel tax to an ad-valorem tax (Box 1). In the attached letter, the authorities request a waiver of nonobservance for the relevant performance criterion. Staff supports the request given the authorities' commitment to seek approval of the legislation at the earliest opportunity and their request to reset conversion of the fuel tax to an ad valorem tax as a performance criterion for the second review (Box 2).

- Congress has also approved legislation giving the executive the authority to eliminate the remaining competitiveness plans; the executive procedures for the elimination are expected to be completed by end-March 2003, in line with the program.

- By March 13, the governors of eight provinces representing a total of 81 percent of the combined deficit of provinces in deficit in 2002 had signed the 2003 bilateral agreements, thereby meeting the associated performance criterion.

- The central bank has issued revised prudential regulations with respect to foreign exchange exposure. Revisions to the prudential regulations on the valuation of government bonds and the classification of bank loans, for which the authorities previously requested a waiver of nonobservance, are still pending.

- The recent strengthening of the *peso* has facilitated a further liberalization of exchange controls, including: (i) an increase in the ceiling on monthly purchases of foreign exchange from US$150,000 to US$200,000, without prior authorization; (ii) an increase in the limit on amortization payments from US$300,000 per month per debtor to US$1 million; and (iii) the ceiling on debts in arrears on which amortization payments are allowed was raised from US$1 million to US$3 million.

- Regarding the dialogue with creditors, the authorities have recently convened creditor meetings in New York and Tokyo, and several further meetings are scheduled, beginning in Paris next week.

9. **The Congress has approved legislation that earmarks any excess revenues (above the budget) from the financial transaction tax to supplement teachers' salaries.** While this may be consistent with the fiscal targets of the transitional program, the earmarking is likely to reduce the flexibility of fiscal policy in future years.

10. **Finally, the submission of legislation to Congress to amend the Financial Institutions Law to strengthen the bank resolution process, and to increase central bank autonomy, has been delayed**. This action, originally envisaged to take place by March 14, 2003, is now expected by the authorities to be taken during the coming week.

Box 1. Continuous and Structural Performance Criteria and Structural Benchmarks: Outcome for the First Review

	Status
I. Performance Criteria	
Continuous performance criteria	
• Nonaccumulation of arrears to bilateral and multilateral creditors.	Observed
• Nonissuance of quasi-monies by provincial governments that have signed the bilateral agreements.	Observed
• No statute or other legal instrument will be adopted that provides a means for any involuntary suspension of creditors' rights.	Observed
March 14,2003	
• Conversion of the fuel tax to an ad-valorem tax and elimination of the income tax exemption on export rebates.	Waiver requested
• Revisions to banking regulations to strengthen the bank supervisory and prudential framework.	Waiver requested
• Signature of the 2003 bilateral agreements by governors of provinces representing a combined total of at least 80 percent of the 2002 consolidated provincial deficit.	Observed
II. Structural Benchmarks	
March 14, 2003	
• Appointment of an external advisor on public debt restructuring.	Observed
• Launch the bidding process for due diligence and strategic review of the public banks.	Delayed

Box 2. Continuous and Structural Performance Criteria and
Structural Benchmarks for the Second Review[1]

I. Performance Criteria

Continuous performance criteria

- Nonaccumulation of arrears to bilateral and multilateral creditors.
- Nonissuance of quasi-monies by provincial governments that have signed the bilateral agreements.
- No statute or other legal instrument will be adopted that provides a means for any involuntary suspension of creditors' rights.

March 31, 2003

- Elimination of the remaining competitiveness plans.

May 15, 2003

- Announce a transitional minimum capital adequacy ratio.
- *Revisions to banking regulations to strengthen the bank supervisory and prudential framework.*
- *Conversion of the fuel tax to an ad valorem tax.*

II. Structural Benchmarks

Continuous

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

May 15, 2003

- Ratification by provincial legislatures of the 2003 bilateral agreements.
- Preparation of draft legislation for structural fiscal measures.
- Congressional approval of amendments to the financial institutions law.
- Launch the bidding process for due diligence and strategic review of the public banks.

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[1] Italics denote reset performance criteria.

Buenos Aires, Argentina
March 14, 2003

Mr. Horst Köhler
Managing Director
International Monetary Fund

Dear Mr. Köhler:

1. We write to you to inform you of further progress made with respect to our commitments under the present Stand-By Arrangement.

2. On March 12, 2003, Congress approved legislation suspending the income tax exemption on export rebates until end-2003. At the same time, Congress is still deliberating the conversion of the fuel tax to an ad valorem tax. We, therefore, request a waiver of the relevant performance criterion for the first review and request that the conversion of the fuel tax to an ad valorem tax be reset as performance criterion for the second review (May 15, 2003). Congress also approved legislation giving the executive the authority to eliminate the remaining competitiveness plans, the procedures for which will be completed by end-March 2003.

3. We have made further progress with respect to the performance criterion on revisions to prudential banking regulations, for which we have requested a waiver in our letter of March 3, 2003. On March 10, 2003, the central bank issued revisions to the regulations relating to foreign exchange exposure, one element of the performance criterion. We are confident that the other elements—revisions to the prudential regulations on the valuation of government bonds and the classification of bank loans—will be completed by end-March, 2003.

4. As of March 13, the governors of eight provinces representing a total of about 81 percent of the combined deficit of provinces in deficit in 2002 had signed the 2003 bilateral agreements, thereby meeting the associated performance criterion.

5. We have also continued to strengthen our dialogue with private creditors, recently convening creditor meetings in New York and Tokyo, and with several further meetings scheduled in the coming weeks.

Sincerely yours,

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

Press Release No. 03/38
FOR IMMEDIATE RELEASE
March 19, 2003

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes First Review of Transitional Stand-By Arrangement with Argentina, Approves US$307 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the first review of Argentina's performance under a seven-month Stand-By Credit Arrangement approved on January 24, 2003 (see Press Release No. 03/09). The arrangement is designed to cover all payment obligations to the IMF through August 2003. Today's decision releases an additional amount of SDR 226 million (about US$307 million) under the Stand-By Arrangement.

The Executive Board also approved Argentina's request for waivers of nonobservance of the structural performance criteria on the issuance of new banking regulations and on the congressional approval of the fuel tax conversion to an ad-valorem tax.

Following the Executive Board discussion, Horst Köhler, Managing Director, said:

"At this stage of the first review of Argentina's program, the financial program is well within the agreed framework. Recent financial and economic indicators are encouraging, pointing to a continuing recovery in economic activity and confidence. There are, however, many challenges ahead. With regard to structural reform, progress is being made in some areas, particularly in dismantling exchange restrictions and strengthening contacts with external creditors; however, in other areas, especially in steps to rebuild the banking system, there have been delays.

"Regarding fiscal policy, the federal primary surplus during January–February 2003 exceeded the programmed level, mainly as a result of higher revenue from income taxes, trade, and the financial transactions tax, as well as prudent expenditure management. A better-than-expected outturn for provincial finances in 2002, and the timely signing by most provincial governors of the 2003 bilateral agreements, should anchor continued provincial adjustment in 2003. The authorities are encouraged to work closely with Congress to secure early passage of the delayed fiscal structural measures, and with the other international financial institutions, with the expectation that this will serve to accelerate disbursements of external loans. Social sector lending is helping to alleviate the social costs of the crisis and preventing a larger share of the population from falling below the poverty line.

"The financial authorities are to be commended for keeping monetary policy in line with the program, increasing the size and depth of the market for central bank paper, and further liberalizing exchange controls. In the coming months, a continued prudent monetary policy will be essential to anchor inflation expectations. The early release of frozen deposits has so far not affected the stability of bank deposits, but this process should continue to be approached with caution. The recent Supreme Court ruling that the *pesoization* of a provincial government's dollar deposit in one state bank was unconstitutional has added to uncertainties that should be resolved as quickly as possible.

"Regarding bank reforms, the Fund looks forward to the implementation of bank and private debt restructuring measures envisaged under the program. It is strongly recommended that the authorities issue a full set of revised prudential regulations, and define, and put into effect, a mechanism to compensate banks for the adverse impact of asymmetric indexation and *amparos* at an early date. The planned diagnostic reviews of the three main public banks should also be launched without further delays. To facilitate private debt restructuring, the authorities should make all efforts to ensure legal certainty and protect creditor rights.

"The authorities have recently intensified their dialogue with private external creditors, and have agreed to draw up an action plan, in consultation with the recently appointed debt advisor, to carry the debt restructuring process forward. While welcoming these actions, the Fund looks forward to further progress being made by Argentina on the preparatory technical work for debt restructuring, including the development of a database of bondholders and the preparation of a menu of options for restructuring.

"The Fund will continue to give full support to the authorities' transitional program in order to underpin stability during the upcoming political transition. The authorities are encouraged to stay the course of their policy commitments under the program. Continued prudent macroeconomic policies, along with progress in the implementation of structural reforms—particularly in the banking and public debt restructuring areas—would facilitate the transition to the new administration, consolidate the recent gains in financial stability, and help to secure timely disbursements of additional external financing," Mr. Köhler said.

Statement by Guillermo Zoccali on Behalf of His Argentine Authorities
March 19, 2003

Overview

1. The first review under Argentina's Stand-by Arrangement approved last January, has provided a good vantage point from which to assess not only recent economic developments, but also the prospects in the social and political spheres. My authorities have appreciated the constructive policy dialogue with Fund management and staff. They are encouraged by the finding that, despite fragilities and the pre-electoral period, the economic recovery continues and all macro-economic performance criteria under the program for end-January were observed with considerable margins. In keeping with their policy of full transparency, they have agreed to the publication of the staff report, while not necessarily agreeing with all the observations made, subject to editing changes that could be appropriate in accordance with the Fund guidelines for release.

2. Equally heartening is that the Argentine society has reaffirmed its vocation to abide by the democratic process. To this end, the major presidential candidates are presenting the electorate with mature scenarios of the circumstances confronting Argentina and the efforts that will be required to strengthen its institutions, secure long-term growth and social stability and maintain a welfare-enhancing link with the international financial community.

Macro-economic Developments

3. Staff have noted the faster than expected consumption-based recovery that began in the second half of 2002. The generalized sentiment is that this process is at last beginning to revert the deep and persistent contraction in economic activity since the end of 1998 that resulted in unprecedented levels of unemployment, poverty and indigence and the steep fall in the value of the currency early last year. In fact, seasonally adjusted industrial production between April 2002 and January 2003 grew by 17.2 percent and labor intensive sectors such as textiles and heavy machinery recovered strongly. This factor together with the implementation of the Heads of Households program contributed to the creation of over 800 thousand new jobs since May.

4. The doubling of the GDP growth forecast for 2003, to around 4 percent, may be explained by the improved demand-side sentiment, in particular consumer confidence. The pent-up demand and the success in keeping inflationary pressures at bay helped spur household spending, auto sales and residential construction. Import substitution following the plummeting value of the peso early last year and the change in relative prices leading to a projected record grain crop also contributed prominently to the improvement in economic indicators.

5. While vigorous export growth has yet to materialize, it is worth keeping in mind that export prices actually declined in 2002 by some 4.5 percent, that comparative advantages in agriculture remains impaired by distortions affecting international supply and market access, that a J-curve lag is to be expected, and that the unwinding of the acute credit crunch has

been slow. Nevertheless, Argentina more than doubled its trade surplus last year, to over US$ 17.5 billion and rebuilt its international reserves position while making net payments to the IFIs in excess of US$ 4.1 billion.

6. Inflation on an annualized basis has also continued to decline. In February 2003 the CPI and WPI increased by 0.6 and 0.4 percent, respectively. In addition, the nominal exchange rate is appreciating gradually since last November despite the steady liberalization of foreign exchange and payments restrictions, including virtually all under the broadest definition of Article VIII. In the current context, the Central Bank's inflation assumption for the year of 22 percent appears attainable.

The Stance of Policies

7. The Stand-by arrangement with the IMF has thus far contributed to strengthening confidence and macro-economic stability that are essential for an orderly political transition and to lay the basis for the structural reforms needed to address sustainability concerns in a medium-term context with the continued support of the international community. Against this backdrop, some additional observations regarding the fiscal, monetary and structural developments bearing on program implementation are deemed warranted.

8. Prudent management of the public finances has and continues to be a cornerstone of my authorities' strategy for stabilization and recovery. On the revenue side, export taxes, inflation, strengthened tax administration and the improved economic activity, in particular since Q4 of last year, raised nominal tax collection through February by some 55 percent YOY and by over 9 percent in real terms. On the expenditure side, it is worth stressing that strict control over public outlays in nominal terms significantly contributed to the improvement that took place in the primary balance. As a result, real primary expenditure in January 2003 was some 10 percent lower than in the same month last year. The combination already resulted in a cumulative primary surplus of the federal government during the first two months of this year that is approximately 85 percent of the end-March target level under the program. Regarding the first fiscal performance criteria for March 14 identified as pending in Box 1, the Congress approved on March 12 the suspension of the income tax exemption on export rebates. The conversion of the fuel tax to an ad-valorem tax which already was passed in the lower house, was sent back to senate committee to clarify technical estimates of yield and is scheduled for reconsideration by the full senate mid next week. In addition, the Congress passed the law delegating to the Executive Branch the elimination of the remaining competitiveness plans, which is a performance criterion for the second review. The pertinent legal instrument to implement this undertaking is being redied.

9. In addition, the provincial finances in aggregate have moved into balance faster than envisaged, and the second pending fiscal performance criteria relating to bilateral fiscal consolidation agreements for 2003 signed with eight provinces accounting for 81 percent of the aggregate deficit has also been met. This has laid the basis for the orderly retirement of provincial quasi-monies amounting to about $1 billion (excepting Lecops, Patacones and Lecor), issued at the height of the crisis. More specifically on the general issue of the provincial finances, the aggregate primary balance reached in 2002 should be seen against an

expected deficit of one-half percent of GDP for the year. This constitutes an adjustment of more than 70 percent with respect to the aggregate 2001 provincial fiscal deficit. In turn, the fiscal consolidation agreements signed by provincial governors for 2003 would represent an additional fiscal adjustment at the provincial level of almost 40 percent with respect to 2002. The commitment by provincial governments that signed the bilateral agreements last year, all except two surplus jurisdictions, to refrain from issuing new quasi-monies has also been met. In fact, no provincial government issued new quasi-monies since the middle of last year, in accordance with the continuous performance criteria under the arrangement. Recognizing the progress made and the importance of fostering further consolidation, my authorities recently announced a staged plan to start a process of orderly withdrawal of outstanding quasi-monies. Initially, bills from eight provinces compliant with fiscal consolidation undertakings would be withdrawn, leaving those issued by the federal government (Lecops), and the provinces of Buenos Aires (Patacones) and Cordoba (Lecor), which represent the bulk of the quasi-monies stock for a second stage. Funding for this purpose would be from the federal government, including possible support from the World Bank, in the form of conditional loans to the eight initially eligible provinces. Work is also underway, with an FAD technical team on the assessment of possible reforms of intergovernmental relations.

10. Enhancing the credibility of monetary policy and the stability of the financial system remains an overriding objective for my authorities. In this regard, as the fears of hyperinflation receded and economic activity began to recover, deposit reflows into the banking system, despite the "amparos" and the lifting of restrictions on reprogrammed time-deposits, maintained the trend that began last July. It should also be kept in mind that over 80 percent of total deposits in the banking system are now free of any restrictions and that the stock of peso deposits has clawed back to the level prevailing last April at the peak of the deposit freeze. In sum, the improved functioning of the payments system, the pick-up in activity and the marked deceleration of inflation all contributed to a noticeable increase in the demand for money, that began last September.

11. My authorities are encouraged by the fact that the conservative monetary targets set for end-January under the program have been comfortably met and that no adjustments have been deemed necessary in this review. The continued favorable evolution of transactions-linked deposit in pesos was encouraged by the policy of attractive interest rates that has enabled the banks to reconstitute their liquidity positions and reduce outstanding liquidity assistance with the central bank. The combination of monetary absorption through a deepened market for Lebacs, reduction in the stock of rediscounts, liberalization of exchange controls and exchange rate flexibility have afforded the central bank significant control over NDA. However, the relatively tight stance has contributed to the gradual appreciation of the nominal exchange rate, only in part compensated by the liberalization of exchange controls, and to the increase in interest rates on Lebacs this year. Neither of these effects have been significant so far. Nonetheless, the present tightening of financial conditions may warrant a second look during the second review, particularly in a context of evidence of a further strengthening in the demand for money and subdued inflation pressures. In this regard, it is worth noting that starting in Q4 of last year the composition of the monetary base changed in favor of a persistently higher participation of money in circulation, pointing to the improvement in real activity and the lower price volatility prevailing since the second half

last year. This development provides greater assurances to my authorities that a progressive liberalization of the much-reduced proportion of reprogrammed time-deposits remaining in the banking system would not trigger significant monetization as the present trend is being underpinned by a strong fiscal effort and a conservative monetary program. In any event, the monetary authorities remain vigilant to maintain the consistency of the monetary stance with the both the requirements of the program and of the recovery during this pre-electoral period.

12. On March 5, the Argentine Supreme Court issued a long-awaited and case-specific ruling declaring unconstitutional the pesoification of the dollar deposits held by the province of San Luis in Banco de la Nacion. Understandably this has triggered renewed discussion within and outside the country. My authorities consider the situation manageable even in the case that this judgment is extended to other depositors. They consider that the ruling, in essence, recognizes the competence of the government to deal with the emergency situation stemming from the crises to return the deposits, within a reasonable time-frame while respecting the original currency of denomination. In any event, the supreme court has granted the parties involved 60 days to agree on the modality and the terms for returning the deposits initially made in dollars. Lack of agreement would require returning the case to the supreme court. In this regard, the administration has reaffirmed its policy of eschewing a compulsory solution. It is also relevant to note that markets have assimilated the news from the supreme court without altering the more favorable climate of expectations, as reflected in the continued firmness of the exchange rate and net purchases of foreign exchange by the central bank, and the generally stabilized interest rates.

13. The concern expressed in the staff paper in relation to "the announced desire of President Duhalde of lifting the remaining restrictions on deposits in the "corralon" (subject to reprogramming) should, thus, be seen in the context of the authorities' recent track-record privileging price stability and the maintenance of orderly financial market conditions. Prudent liberalization has been part and parcel of their reform strategy. In fact, the recent announcements by the central bank increasing: i) the prudential limit on the foreign currency holdings of banks, to 30 percent of total net assets, and ii) the allowance for portfolio purchases of foreign exchange up to US$ 200,000, together with the authorization for prepayment of import credits, were well received. Similarly, the issuance of transparent, new guidelines for liquidity assistance, provide clear indications of the commitment of the authorities to advance the liberalization in a sequenced fashion and in consonance with the evolving conditions of the financial markets. They view the eventual removal of restrictions on remaining reprogrammed time deposits as part of this same process, and as a factor that could further contribute to strengthening confidence while simultaneously enhancing market discipline conducive to maintaining the consistency of the macro-policy mix.

14. Regarding conditionality in the structural area, it is important to distinguish between actual undertakings contemplated in the authorities' program and measures which they recognize as desirable but which either do not form part of the program conditionality or may apply in a subsequent test date. This helps to put in proper perspective staff doubts regarding degree of observance in paragraphs 11, 19 and 20 of their report referring to identified measures such as the mechanism to compensate banks for the impact of asymmetric indexation and "amparos", further refinements to the framework for private debt

restructuring and the strengthening of the central bank autonomy, respectively, all of which are substantially advanced.

15. The brief additional extension motivating my authorities' request for partial waiver for nonobservance of the structural performance criterion on new prudential regulations, relates to the valuation of government loan and bonds and commercial loan classification requirements and should be seen in the context increased ambitiousness of the new authorities of the central bank to use the opportunity to expand the scope of the prudential guidelines and include a forward-looking perspective. As noted earlier, the revision to the norms for foreign exchange exposure have already been issued and my authorities are intensively working on the valuation of government debt instruments and loan classification requirements under the broader focus, for completion by end-March, 2003, and on the new capital-adequacy requirements for issuance as envisaged as part of the performance criteria for the second review by May 15. Similarly on the implications of draft legislation on voluntary out of court procedures noted in paragraph 12, my authorities are being guided by the spirit of the continuous performance criterion on the avoidance of any involuntary suspension of creditor rights and expect to submit it to Congress by the time of the third review. In fact, bankers also expressed the sentiment that rushing this issue in the present circumstances could be counterproductive.

16. On the privatized utilities, the government is engaged in a process of renegotiation of contracts dictated by the Emergency Law of 2002. My authorities consider that the recent joint World Bank/Fund technical assistance mission produced a very useful assessment of the legal, regulatory and financial aspects of the ongoing process, rightly emphasizing the importance of defining a new, long-term framework.. In addition, they welcome the legitimacy the mission afforded to the concept of "social tariff", an important element to address social equity considerations, which was missing from the regulatory frameworks put in place in the 90's. In the meantime, the government has been trying to advance partial utility rate increases by way of three presidential decrees since last September and has appealed the court ruling issued at end-February rolling-back the increases that had been authorized for electricity and gas.

17. My authorities fully share the need to affirm a process to restructure Argentina's debt and normalize the relationship with its private external creditors in a manner that addresses inter-creditor equity concerns, and the need to reconcile debt sustainability with long-term growth and stability. The initial progress made in stabilizing the domestic financial system, in fostering the recovery and in putting in place a transitional Stand-by arrangement with the Fund provide conditions for improved frequency and quality in the dialogue as the first steps in this process that constitutes a national priority. Following preliminary contacts with investors in meetings held in Buenos Aires, the United States, Europe and Japan, my authorities appointed an external advisor on debt restructuring last February 27th. This has been followed by further direct contacts with a wide cross-section of bondholders in New York and Tokyo. Additional meetings are scheduled in Rome, Frankfurt, and other European financial centers in the coming weeks. The aim is to identify the creditor base and its concerns and foster the formation of working groups among different classes of asset holders as a basis for future negotiations. Work is moving ahead on these fronts, including the

compilation of the needed investor/instrument database, to lay the groundwork for expeditious negotiations by the incoming administration.

18. My authorities are appreciative for the support received from the international community to help Argentina address its imbalances. In particular, the Stand-by Arrangement with the IMF and the resumed lending of the IADB have served to stabilize net financing flows and reduce the debt servicing burden to these institutions. My authorities have been working intensively to ensure a similar outcome in the coming months in respect of identified lending agreed with the World Bank and look forward to close collaboration consistent with the envisaged financing assurance reviews under the program.

19. Mindful of its international responsibilities, the government of Argentina has also been active in the area of anti-money laundering and combating the financing of terrorism. In this connection, it has communicated its request to participate in the ROSC program on these issues in the fourth quarter of 2003.

Conclusions

20. My authorities see the attainment of the objectives in the current stand-by arrangement with the Fund as essential for the orderly restoration in Argentina of equitable, long-term growth with external sustainability. The challenges that remain in the economic, political and social spheres are daunting and the leeway in this pre-electoral period is constrained. However, my authorities are encouraged by the progress made in reverting the painful consequences of this unprecedented crises and are determined to advance implementation of the agreed undertakings to facilitate the transition towards the medium-term structural reforms that need to follow. The continued support of the IMF and the international community for this program and for helping to maintain its financing assurances in the coming months will be critical for the success of the effort.