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

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

- the staff report for the second review under the Stand-By Arrangement and request for waivers of nonobservance and applicability of performance criteria, prepared by a staff team of the IMF, following discussions that ended on **June 6, 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 June 13, 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 Press Release summarizing the **views of the Executive Board as expressed during its June 20, 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

Second Review Under the Stand-By Arrangement and Request for Waivers of Nonobservance and Applicability of Performance Criteria

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

Approved by John Dodsworth and G. Russell Kincaid

June 13, 2003

- **Stand-By Arrangement**. An eight-month arrangement for SDR 2.17 billion (US$2.9 billion, or 170 percent of quota on an annual basis) was approved by the Executive Board on January 24, 2003 (Table 1). This access was broadly equivalent to obligations (including charges) falling due during the period January 24–August 31, 2003. All repurchase expectations during the period of the arrangement (amounting to SDR 2.8 billion) were converted to an obligations basis. Cumulative purchases, so far, amount to SDR 973.2 million; completion of the second review would allow a purchase of SDR 226.2 million.

- **Discussions**. Discussions were held in Buenos Aires during April 28–May 9 and June 4–6 with Minister Lavagna, Central Bank President Prat-Gay, and other senior officials and private sector representatives. The staff team comprising Messrs. J. Dodsworth (Head), J. Thornton, A. Cebotari, L. Giorgianni, E. Ramirez (all WHD), A. Arvanitis (PDR), M. Petri (FAD), Ms. R. Weeks Brown (LEG), and Ms. Pinillos (Assistant, WHD), was assisted by L. Cubeddu, the Fund resident representative. An MFD mission, led by Mr. Hoelscher, participated in the discussions. Mr. Zoccali (Alternate Executive Director) attended the policy meetings.

- **Economic developments**. A measure of confidence is returning, with the resumption of economic growth and relative stability in financial markets. The quantitative performance criteria for end-March were observed, but there were delays in structural reform. Waivers are requested for five structural performance criteria: (i) fuel excise tax reform, (ii) revisions to banking regulations, (iii) announcement of a minimum capital adequacy ratio, (iv) elimination of the competitiveness plans, and (v) prohibition of involuntary measures restricting creditors' rights. The first three have now been implemented. Four structural benchmarks were also not observed in the fiscal and banking areas. A waiver of the applicability of fiscal quantitative performance criteria for end-May is also requested.

- **Political situation**. Mr. Kirchner, who was elected president following Mr. Menem's withdrawal from the runoff vote, assumed office on May 25.

- **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 plans for the remainder of the transitional program.

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I. Introduction

1. **Mr. Kirchner assumed the presidency on May 25 following the withdrawal of ex-President Menem from the second round runoff**. The new President has moved quickly to extend political control. In the first two weeks, he has urged congress to reopen impeachment hearings against supreme court members, retired high-ranking military officers, announced the deregulation of powerful labor unions, and moved to replace some central bank directors. A critical factor determining whether political support can be mobilized for major policy initiatives will be the busy calendar of gubernatorial and legislative elections in the second half of 2003, with all but two provinces to elect governors, and half of all national deputies and one-third of senators to be elected. There has been continuity in the economic team with Minister of Economy Lavagna and Central Bank President Prat-Gay retaining their positions.

2. **While all end-March quantitative performance criteria were observed, there were slippages in meeting structural conditionality** (Table 2 and Box 1). Five structural performance criteria were not observed, though three of these (two in the banking area and one related to tax reform) have now been implemented.[1] The remaining two relate to the elimination of the competitiveness plans and a stay on mortgage foreclosures. The latter breached the continuous criterion against measures that provide for the involuntary suspension of creditor rights.[2]

II. Recent Developments

3. **Market sentiment continues to strengthen**. The *peso* has appreciated significantly, international reserves have increased, and interest rates have eased in line with lower inflation. Consumer confidence is also recovering strongly. The improving situation reflects, inter alia, cautious macroeconomic policies, a continued large external trade surplus, and the further accumulation of arrears to external private creditors.

4. **Growth is recovering, while inflation has fallen further**. Preliminary estimates suggest that first quarter real GDP increased by 2¾ percent relative to the previous quarter (seasonally adjusted), while industrial production showed further gains in recent months (Figure 1). The recovery appears mainly driven by import substitution sectors, benefiting from last year's large relative price adjustment (Annex I). However, unemployment remains high (18 percent) and poverty still affects about half of the population. The monthly rate of consumer price inflation has fallen steadily (turning slightly negative in May), reflecting the

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[1] Four structural benchmarks were also not observed in the fiscal and banking areas.

[2] The remaining competitiveness plans are to be allowed to expire in July and December 2003, while the stay on mortgage foreclosures will continue for 90 days from June 2, 2003; the authorities have yet to clarify whether the stay refers to business of judicial days, the latter being for a considerably longer period.

still large output gap, the recent appreciation of the *peso*, and a continuing freeze on utility prices.

5. **Large trade surpluses continue, despite a weak export performance**. In the first four months of 2003, growth in export volume was close to zero, with only agro-industrial exports showing marked expansion, but this was explained by a strong pickup in export unit values. Imports are recovering strongly, but from very compressed levels (Figure 2). In May, exchange controls were liberalized further, in response to the steady appreciation of the *peso* (SMEP, paragraph 11). Notwithstanding the buoyant trade surplus and limited foreign debt payments, gross international reserves increased by only US$1 billion during January–May, largely reflecting continued outflows by the private sector (net repayments to the IFIs were about US$1 billion in this period). Arrears continue to rise steeply on unrestructured debt.

6. **Base money growth has been rising, mostly reflecting unsterilized purchases of foreign exchange**. The end-March indicative target for base money was exceeded by about 1 percent, although the performance criteria for net international reserves and net domestic assets of the central bank were met with wide margins. Base money continued to grow rapidly in April and May. Bank deposits remained relatively stable following the announcement of the lifting of the *corralón* in April (see Section III.C below) and have shown some moderate growth more recently, while interest rates on central bank paper (*lebacs*) have eased considerably, especially at longer maturities (Figure 3). The stability of bank deposits, the strength of the *peso* and the absence of inflationary pressures suggest that the recent increase in money supply has a counterpart in recovering demand for *pesos* from very low levels.

7. **The first quarter fiscal targets were achieved, but delays on VAT refunds have emerged**. The consolidated cumulative primary surplus was roughly Arg$400 million above the target for March, about equivalent to the estimated new federal domestic arrears on VAT refunds to exporters. At the federal level (Tables 3 and 4), the outturn was due mainly to lower-than-envisaged primary spending (though social program expenditures were as budgeted) and the delays in VAT refunds to exporters. On the revenue side, overperformance in tax collections—particularly income taxes—was more than offset by weaker nontax revenues. Preliminary data for April and May indicate that the program remains broadly on track at the federal level. The provincial fiscal outturn was also slightly better than expected during the first quarter with the provinces registering a primary surplus Arg$100 million higher than projected (Table 5). There was a strong recovery in provinces-own revenues, while their primary spending was kept broadly in line with commitments under the 2003 *bilateral agreements*. By mid-May, the legislatures of eight provinces (representing 80 percent of the provincial 2002 deficit) had ratified the 2003 bilateral agreements, thereby meeting the related structural benchmark for the second review.[3] There were, however, delays

[3] Since then, four more provincial legislatures have ratified their 2003 bilateral agreements, making total ratification equivalent to 92 percent of the provincial 2002 deficit (SMEP, paragraph 7).

in the reporting of January and February provincial fiscal data, resulting in nonobservance of a continuous structural benchmark (SMEP, paragraph 8).

8. **Delays in disbursing programmed external loans from the MDBs necessitated higher central bank credit to the government.** A shortfall of about US$0.8 billion emerged through end-April—mainly reflecting delays in disbursements from the World Bank—but was largely made up in May (Table 6).

9. **In May, the authorities began the redemption of all outstanding federal and provincial quasi-monies issued during 2001–02**. The redemption is supported by financial assistance from the World Bank (Annex II and SMEP paragraph 9) and is within the framework of the financial program. By early June, the equivalent of about Arg$1.5 billion (accounting for about 15 percent of the outstanding stock) of quasi-monies had been redeemed. All quasi-monies are expected to be redeemed by end-year.

III. Report on the Discussions

A. Macroeconomic Framework

10. **The macroeconomic framework for 2003 has been revised to incorporate higher economic growth and lower inflation** (Tables 7, 8, and 9). Real GDP growth is now forecast at about 4 percent, broadly in line with the latest consensus forecast, while consumer prices are expected to increase through the year by about 15 percent. The authorities noted the potential for a stronger growth outcome and continued overperformance on inflation. However, risks to the outlook remain given the weakness of the export response, the continuing lack of bank credit, and uncertainties about the medium-term outlook.

B. Fiscal and Monetary Policies

11. **The authorities reaffirmed their commitment to achieve the nominal fiscal targets for 2003**. They expected tax revenues to remain on track, despite lower inflation and a stronger exchange rate in light of buoyant income tax collections thus far.[4] On expenditures, the authorities reaffirmed their intention to contain primary spending while clearing domestic arrears and maintaining social spending programs. They will be making efforts to eliminate arrears on VAT refunds to exporters. Given progress in the ratification of *bilateral agreements*, the authorities were confident that the good performance at the provincial level would be extended in the period ahead.

12. **End-June debt ceilings are proposed to be modified to accommodate higher-than-anticipated issuance of bonds.** Adjusters to the debt ceilings were introduced to accommodate the fiscal costs of the schemes to retire provincial and federal quasi-monies (up

[4] On preliminary figures, cumulative federal tax revenues during April–May were almost 9 percent above target.

to Arg$7.8 billion to be placed with the central bank) and to release deposits from the *corralón* (about US$1.7 billion to be issued to depositors) (SMEP, paragraph 12). These measures are being implemented earlier than envisaged in the original program, and are likely to lead to an increase in public debt of about US$3½ billion. Total public sector debt (including to the IFIs) is thus projected to be 132 percent of GDP by end-2003, compared to about 54 percent of GDP at end-2001.

13. **The fiscal structural agenda has been delayed further**. The authorities failed to eliminate all competitiveness plans at end-March (a performance criterion for the second review) and, indeed, extended those for the media and freight transportation to end-July, while retaining the plan for passenger transportation until end-December.[5] The authorities contended that, given the pre-election political climate, it was not—after all—feasible to take action in this area, but that there would be no further extensions (covered by a continuous structural performance criterion from end-July). As regards the conversion of the fuel excise tax to an ad valorem basis (a performance criterion that had been reset from the first review), congress approved the relevant legislation on June 4, 2003, but the measure is unlikely to have the expected positive revenue yield.

14. **The monetary program has been revised to reflect an improved economic outlook and reduced inflationary risks**. Base money for the remainder of 2003 is now targeted to rise broadly in line with nominal income, allowing the authorities greater scope to accumulate reserves and dampen the pace of *peso* appreciation (Table 10). Given the indications of a recovering money demand, the revised monetary program still remains cautious, while allowing room for interest rates to fall further.[6]

C. Structural Reforms

Bank restructuring

15. **There have been further delays, but efforts to advance the bank restructuring agenda have been recently stepped up**. Progress has been made in further liberalizing deposits, adopting a transitory prudential framework—including a revised capital adequacy regime—and defining a strategy for diagnosing the financial position of private banks. However, several key aspects of the strategy were further delayed, notably in effecting compensation to banks for *amparos* and asymmetric indexation, reforming public banks, and strengthening the institutional framework for central bank autonomy and bank resolution.

[5] In March 2003, congress approved legislation authorizing the executive to eliminate all the remaining competitiveness plans. Twenty-seven sectoral competitiveness plans that had been suspended in December 2001 were eliminated, and legislation was abolished that would have generalized the competitiveness plans economy wide as of April 2003.

[6] The ceiling for net domestic assets of the central bank was reduced to lock in part of the overperformance to date, and the floor for net international reserves was raised.

16. **The government launched in April a voluntary scheme to eliminate restrictions on reprogrammed time deposits (the *corralón*) and compensate depositors for *pesoization*.**[7] Despite the favorable terms of the scheme, only about 50 percent of total deposits exited the *corralón* before the offer expired on May 23.[8] The authorities explained that, before entering the scheme, some depositors were waiting for the election result, as well as for greater clarity on the implications of the March 3, 2003 supreme court ruling on the unconstitutionality of the *pesoization* of the deposits of a provincial government. In addition, depositors with pending judicial injunctions (*amparos*) were unlikely to opt for the scheme in the hope that they would recover their deposits in U.S. dollars. It is estimated that roughly three-fourths of withdrawals under the scheme have been redeposited within the system, though this ratio was lower for the public banks.

17. **The central bank has announced a revised bank regulatory regime.** The new regime includes transitory prudential rules on the classification and provisioning of commercial loans, new rules on the valuation of government bonds and loans, and a new capital adequacy standard that is lower than in the pre-crisis situation, but broadly in line with international standards.[9] The revisions to the prudential norms accord temporary forbearance that was not envisaged in the original banking strategy, which contemplated strict loan classification and provisioning (LCP) rules, together with a phasing-in of marking-to-market of bank claims on the government, and of a transitory minimum capital adequacy requirement. In the event, the authorities decided to extend forbearance, inter alia, by easing significantly loan classification and provisioning requirements, and by phasing in some aspects of the capital requirement.[10] To advance the banking strategy, and to mitigate staff concerns about excessive forbearance, the authorities eliminated certain problematic aspects of the LCP rules on May 22, 2003.

18. **The new prudential regulations, though temporary, complicate the assessment of the true financial condition of banks.** Nevertheless, to avoid further unwarranted delays, the central bank will require banks to provide detailed business plans and cash flow projections covering the following 24-month period by end-October 2003. Based on the

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[7] Under the scheme, deposits below Arg$42,000 (Arg$6.3 billion) are payable in cash; deposits between Arg$42,000–Arg$100,000 (Arg$4 billion) will be returned in the form of a 90-day time deposit; deposits above Arg$100,000 (Arg$7.3 billion) will be returned in the form of a 120-day time deposit. The compensation—at a fiscal cost of about US$1.7 billion, or 1.3 percent of GDP—is to be paid to depositors following the Supreme Court ruling that the *pesoization* of the deposits of a provincial government was unconstitutional.

[8] After May 23, the corralón became effective once again for those deposits that did not enter into the scheme.

[9] The new capital adequacy standard that was announced on May 29, 2003, includes a core ratio of 8 percent that applies to exposures to the private sector as well as to the public sector, and additional capital charges for interest rate risk and market risk.

[10] The central bank plans to announce in July 2003 transitional paths for meeting the capital requirements related to public sector exposure and interest rate risk.

analysis of bank business plans, the superintendency will, by the end of the year, be in a better position to assess the viability of the banks and their compliance with regulatory requirements. Shareholders of viable, but undercapitalized, banks would be required to submit time-bound rehabilitation plans, to be approved and monitored by the superintendency. Failure to meet interim targets in the rehabilitation plan would result in the bank being resolved.

19. **The authorities indicated their intention to make up for the delays in the implementation of other key aspects of the bank restructuring strategy**. These areas (described in SMEP, paragraph 12) include:

- **Completion of bank compensation for asymmetric *pesoization*, asymmetric indexation and *amparos*.** Legislation authorizing compensation for asymmetric indexation and amparos is currently in congress but is, in the staff's view, inappropriate in that it links compensation payments to lending targets for the banks.

- **Initiating the reform process of the three largest public banks.** The authorities are launching the bidding process for international accounting firms and management consultants in a staged manner. The process was initiated on May 21, 2003, with Banco de la Nación, and will be followed in June 2003 with Banco Provincia de Buenos Aires. The authorities have previously committed to launching a similar process for the third main public bank, Banco Ciudad de Buenos Aires, but have been unable, so far, to secure the cooperation of its owner, the city of Buenos Aires. A reassessment of the appropriateness of including Banco Ciudad de Buenos Aires in the process will be made by the third review.

- **Congressional approval of the amendments to the financial institutions law,** with a view to strengthening the procedures for resolving problem banks and providing greater central bank autonomy. The amendments to the financial legislation submitted to congress on May 23 provide somewhat greater protection of public officials by: (i) broadening the authority of officials to perform restructuring actions; and (ii) limiting judicial review of certain discretionary assessments made in the bank resolution process. However, the amendments also effectively raised the existing limit on central bank advances to the government and failed to strengthen central bank budgetary procedures and do not provide the fuller protection to central bank officials previously envisaged. The authorities have agreed to work with legislators to limit congressional approval to the administrative budget of the central bank, and to obtain approval of the legislation by the third review.

20. **A new coordinating entity for bank restructuring was established by decree on May 26**. The Financial System Restructuring Unit (FSRU) was charged with the design of the bank restructuring strategy, consistent with the objective of strengthening coordination among

agencies involved in bank restructuring.[11] A number of aspects of the enabling decree could raise concerns: (i) the mandate of the unit is not well defined and could be broadened by the executive; (ii) because of its power to implement bank restructuring measures, the unit may infringe on the mandate entrusted on other implementing agencies; and (iii) the unit can unilaterally modify the financial conditions of central bank assistance to banks, which is mostly concentrated in the public banks. Staff emphasized to the authorities the need to limit the mandate of the FSRU by, inter alia, minimizing any overlap between the core responsibilities of the central bank and those envisaged for the FSRU.

Safeguards assessment

21. **Staff recommendations on the central bank safeguards assessment program are being implemented**. Agreement was reached between the central bank and the government to put in place a mechanism to preclude the distribution of unrealized valuation gains and any advance distribution of profits. To this end, the central bank will enter into a memorandum of understanding with the government by the third review of the program. In addition, the central bank has committed to prepare 2003 financial statements in accordance with the International Accounting Standards, for which preparatory work is underway.

Legal issues

22. **On May 8, congress approved legislation suspending for 90 days all foreclosures related to loans secured by property that constitutes a sole family dwelling**. The law—which became effective on June 2—breaches the performance criterion designed to protect creditor rights and heightens concerns over legal certainty. It is also likely to have adverse effects on business confidence, incentives to repay loans, and the restoration of credit flows. The authorities noted that the law had been introduced at the initiative of the legislature and that it had been approved unanimously, making it unlikely that a presidential veto of the legislation would be sustained. Total foreclosure filings account for only a small share of bank lending to the private sector, and lenders are not prevented from initiating or continuing foreclosure proceedings (Box 3). The authorities have committed to make every effort to ensure that this latest stay will not be extended and that no further measure infringing on creditor rights will be introduced (SMEP, paragraph 13). Staff was also informed that the out-of-court workout legislation, expected by end-May 2003, would be delayed.

Structural fiscal reforms

23. **The authorities are preparing draft legislation for a comprehensive reform of the tax system and of intergovernmental relations**. It was expected that the main features of the legislation would take into account recent FAD technical assistance. However, the

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[11] The unit comprises three representatives of the ministry of economy and three of the central bank, and is chaired by a president elected among members, one year from the ministry and one year from the BCRA.

authorities' initial submission of the key aspects of their proposals (in the form of white papers) to the staff and provincial governors deviates from FAD recommendations, particularly in regard to the primary distribution of revenues between the federal government and the provinces.[12] Moreover, the details of the authorities' tax reform proposal have not yet been sufficiently elaborated to determine whether it would yield the necessary revenue increases. These issues will be taken up in the third review of the program.

D. Debt Restructuring

24. **Progress in advancing negotiations with external creditors on public debt restructuring has been limited**, reflecting the authorities' desire to let the incoming administration take the lead on this key issue. Nevertheless, the process of normalization of relations with bilateral official creditors has been advanced, and the terms of reference for the reorganization of debt falling due through August 2003 with Paris Club creditors is expected to be signed by the time of the Board meeting. Since the time of the previous review, the authorities have also been preparing an action plan with the assistance of their external debt advisors and have convened creditor meetings in Boston, New York, Rome, and Tokyo. Finally, the authorities have made progress toward building a creditor database and are in the process of upgrading their investor relations website.

IV. Staff Appraisal

25. **Sound macroeconomic policies have been key to improving market sentiment and smoothing the political transition.** A measure of confidence is returning with the ongoing economic recovery and relative stability in financial markets. Inflation has decelerated sharply and, in the context of a strengthening *peso*, it has been possible to accumulate reserves while lowering domestic interest rates. Macroeconomic policy performance has been in line with the program, reflected in observance of all end-March quantitative performance criteria. The quantitative performance criteria for end-May are also expected to be observed, although the fiscal data would not be available until after the Board meeting. This good performance will be difficult to sustain, however, without adequate structural reforms.

26. **Implementation of structural reforms has been disappointing.** The authorities have taken important steps—not incorporated in the program—toward lifting deposit restrictions and redeeming quasi-monies. However, in a number of critical areas, measures committed under the transitional program were considerably delayed or postponed. The delays appear to reflect a combination of insufficient political consensus and the interim government's reluctance to take fundamental steps ahead of the elections. The new administration needs to guard against adopting the view that the economy is smoothly moving

[12] The authorities' proposal for reforming the primary revenue distribution may be incompatible with reaching the primary surplus targets and would not solve the problem of insufficient incentives for own fiscal efforts at both levels of government.

back to a normal situation without the necessity of structural reforms. The massive debt overhang in the public and private sectors and lack of normalization of relations with creditors, an undercapitalized and unprofitable banking system, and an unfavorable investment environment represent major obstacles to turning the nascent recovery into sustained growth.

27. **The introduction by congress of a further stay on mortgage foreclosures, while of limited immediate impact, sends a highly negative signal about the protection of creditor rights**. It appears that the link between legal certainty and new investment is still not widely understood. Staff also regrets the continued delay in compensation payments to banks which is an important element of the banking strategy. The linking of compensation to new lending by the banks—which is under consideration by congress—would be counterproductive to the aim of restarting financial intermediation.

28. **Continuation of a prudent fiscal policy will be the first challenge for the new administration**. Budgetary performance to date has been commendable, especially in an election period. However, looking forward, the budget appears very tight for the remainder of the year and it will be important for the new government to resist new spending initiatives, both at the federal or provincial level, in the absence of revenue enhancing measures and a clear medium-term fiscal framework. Equally, there is a need to avoid expenditure compression spilling over into domestic arrears or undermining social program priorities. In particular, the early elimination of arrears on VAT refunds should be a priority for the government. The authorities need to refrain also from the assumption of new debt-creating operations beyond those agreed under the program. They should continue to work with the MDBs to ensure that financing flows are maintained at program levels.

29. **A cautious easing of monetary policy appears warranted given recent price and exchange rate trends.** The central bank has overperformed in respect of the original monetary program, and its desire to build reserves more rapidly can be supported. There is evidence of recovering money demand and the lifting of the *corralón* has not undermined financial stability. However, deposits in the banking system are not yet showing significant growth and the durability of the recovery in money demand remains to be tested. In these circumstances, it is essential that the authorities remain vigilant to inflationary pressures or signs of deposit instability.

30. **The new administration faces enormous challenges in advancing toward an appropriately comprehensive structural reform program**. The structural component of the transitional program was quite limited, yet its implementation has proven to be very difficult. Within the remainder of the arrangement, the authorities are encouraged to meet their commitments under the program, particularly in regard to: eliminating (in July) competitiveness plans for media and freight transport; further developing the strategy for restructuring banks, including those that are publicly owned; securing passage of adequate amendments to the Financial Institutions Law, including limiting congressional scrutiny to the administrative budget of the central bank and clarifying legal protection for officials involved in bank resolution; developing the draft legislation to support the structural fiscal reforms; and

accelerating the pace of interactions with creditors. Beyond the current program, the challenge will be to formulate an agenda of substantial economic, institutional, and legal reforms that will improve the investment climate, establish a robust fiscal framework to underpin debt restructuring, and restore financial intermediation within a viable banking system. Staff look forward to working with the authorities on this agenda in the context of a successor arrangement

31. **Staff regrets the delays in the structural reform program that led to the nonobservance of several structural performance criteria and structural benchmarks under the program**. However, given that all macroeconomic targets have so far been achieved, and on the basis that several key structural measures have been carried out subsequently, or reset for a later date, staff recommends the granting of the requested waivers and modifications to performance criteria and supports the completion of the second review, including of financing assurances.

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

	Status	Comments	Actions
I. Performance Criteria			
Continuous			
• Nonaccumulation of arrears to bilateral and multilateral creditors	Observed		TOR for the reorganization of debt with Paris Club creditors expected to be signed by the second review Board date
• Nonissuance of quasi-monies by provincial governments that have signed the bilateral agreements	Observed	In May, the authorities began to redeem federal and provincial quasi-monies.	
• No statute or other legal instrument will be adopted that provides a means for any involuntary suspension of creditors' rights	Waiver requested	On May 8, congress approved a bill to impose a 90-day stay on foreclosures of mortgages; the law became effective on June 2.	Authorities have committed to make every effort to prevent an extension. The stay will have a limited immediate impact.
March 31, 2003			
• Elimination of the remaining competitiveness plans	Waiver requested	Will not be fully implemented during the arrangement period.	Elimination of plans for media and freight transport by end-July; those for passenger transportation expire at end-December 2003.
May 15, 2003			
• Revisions to banking regulations to strengthen the bank supervisory and prudential framework	Waiver requested	Reset from first review. The new rules extended excessive forbearance.	Revised regulations, eliminating certain problematic aspects of prudential rules, announced on May 22.
• Announce a transitional minimum capital adequacy ratio	Waiver requested	Revised capital adequacy regime announced on May 29.	BCRA to announce by July 25 transitional paths for meeting the capital requirements related to public sector exposure and interest rate risk.
• Conversion of the fuel tax to an ad valorem tax	Waiver requested	Reset from first review.	Approved by congress on June 4.
II. Structural Benchmarks			
• Provide monthly information on provincial government financing with a delay of less than 55 days (*continuous*)	Not observed	Not observed for January and February data.	Data for end-March provided on a timely basis.
May 15, 2003			
• Ratification of the 2003 bilateral agreements	Observed	Twelve provinces have now ratified.	
• Preparation of structural fiscal draft legislation	Not observed		Draft "white papers" provided to Fund staff and provincial governors in late May for comments. (Not fully consistent with FAD recommendations.)
• Congressional approval of amendments to the financial institutions law.	Not observed	Draft law submitted to congress on May 23, but fails to strengthen BCRA autonomy and provide legal protection for officials involved in bank resolution.	Authorities have committed to work with legislators to limit congressional scrutiny to the administrative budget of the BCRA. No significant progress with respect to legal protection for officials.
• Launch the bidding process for due diligence and strategic review of three public banks (Banco de La Nación, Banco Provincia, and Banco Ciudad).	Not observed	Reset from first review. Bidding process launched for Banco de La Nación on May 21.	Bidding process scheduled for Banco Provincia expected by second review Board date. Assessment pending of the appropriateness of including Banco Ciudad in the due diligence and strategic review process.

Box 2. Continuous and Structural Performance Criteria and Structural Benchmarks for the Third 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.
- Remaining competitiveness plans will not be extended beyond July 31, 2003, except for public transportation which will be terminated by end-December, 2003.

II. Structural Benchmarks

Continuous

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

July 25, 2003

- Congressional approval of amendments to the financial institutions law.
- Agreement on a memorandum of understanding between the central bank and the government on the conditions for the transfer of realized central bank profits.
- Announcement of transitional capital requirements for exposure to the public sector and interest rate risk.

Box 3. The Stay on Mortgage Foreclosures

Legislation imposing a 90-day stay on mortgage foreclosures became effective on June 2. The measure breaches the performance criterion prohibiting the adoption of measures that provide a means for the involuntary suspension of creditors' rights.

The law is broad in scope. It suspends all foreclosures involving loans secured by a sole family dwelling, regardless of the nature of the underlying obligation. As such, the stay applies not only to foreclosures involving home purchase loans but also to cases where the underlying loan was for other purposes and simply collateralized by a house. The few exceptions include obligations related to alimony, labor claims, criminal commissions, and tort liability claims.

The immediate direct impact of the law appears to be limited. Specifically, (i) total foreclosure filings account for about 2 percent of bank lending to the private sector, and judges have ordered foreclosures in less than one-third of the filed cases; (ii) the foreclosure process is protracted, typically taking 1½–2 years for cases to move from the initial filing to actual sale of the property; and hence the stay should not have an impact on foreclosure cases filed shortly before or after the law came into effect; and (iii) the law does not prevent lenders from initiating and continuing foreclosure proceedings, but only from *executing* the final foreclosure order.

The law appears unlikely to lead to a large increase in strategic arrears by borrowers who are otherwise able to service their loans: (i) the fact that lenders can still initiate foreclosure proceedings will likely discourage borrowers who have resources to pay; (ii) many loan contracts contain terms (e.g., punitive default interest rates, and acceleration clauses) that are intended to discourage strategic arrears; and (iii) banks report that mortgage borrowers normally go to great lengths to avoid nonpayment, particularly given that the value of real estate is in many cases now much greater than the (*pesoized*) value of the loan secured by the property; this may help explain the fact that nonperforming mortgage loans have actually decreased over the last year despite the existence of various stays.

The main adverse effects are likely to be indirect. The law adds to legal uncertainties, serves to reinforce a culture of nonpayment, and reduces the leverage of creditors in loan restructuring negotiations with troubled borrowers. However, the law is likely to have a large direct negative impact on *nonbank creditors* (mostly small credit companies engaged in providing loans to less creditworthy borrowers), a large share of whose lending is typically secured by mortgages (reliable statistics are not available on pending foreclosures by such companies).

Argentina- Implications of Mortgage Foreclosure, May 2003

		In percent of	
	Arg$ m	Private credit	Total mortgages
Private sector credit	35,290	100.0	...
Mortgages	10,675	30.2	100.0
NPL sole-family home mortgage	2,216	6.3	20.8
Category 5 loan	1,549	4.4	14.5
Foreclosure filed	757	**2.1**	**7.1**
Filed with court sentence	222	**0.6**	**2.1**

Source: BCRA, Debtor database.

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

Date	Amount in millions of SDRs	In percent of quota	Conditions
January 24, 2003	747.0	35.3	Disbursed on Board approval
March 20, 2003	226.2	10.7	Disbursed on conclusion of the first review
June 20, 2003	226.2	10.7	Observance of end-March 2003 performance criteria and completion of second review
July 25, 2003 2/	748.9	35.4	Observance of end-May 2003 performance criteria and completion of third review
August 25, 2003 3/	226.2	10.7	Observance of end-June 2003 performance criteria
Total access 4/	**2,174.5**	**102.7**	

1/ All purchases are subject to financing assurances reviews and adherence to continuous structural performance criteria.
2/ Rephased from June 29, 2003.
3/ Rephased from August 15, 2003.
4/ Total access on an annual basis is 170 percent of quota.

Table 2. Argentina: Quantitative Program Targets and Outcome, January-June 2003 1/

(In millions of pesos, unless otherwise indicated)

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

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

2/ Indicative targets throughout the program period.

Table 3. Argentina: Federal Government Operations, 1999-2003

					2003		
					Jan-Mar		
	1999	2000	2001	2002	Act.	Prog.	Year
	(In billions of pesos)						
Revenues	**55.0**	**55.8**	**50.4**	**56.4**	**16.3**	**16.7**	**76.8**
Tax revenues	38.6	40.7	37.2	41.7	12.1	12.1	59.8
Social security contributions	10.9	10.7	9.6	9.7	2.9	2.9	11.7
Nontax revenues 1/	5.5	4.5	3.6	5.0	1.3	1.7	5.3
Primary expenditure	**54.0**	**53.1**	**50.2**	**54.2**	**14.5**	**15.2**	**66.7**
Primary expenditure (excl. provincial transfers)	36.1	35.1	33.2	37.0	10.3	10.9	45.8
Of which:							
Wages	8.5	8.4	7.8	8.0	2.3	2.2	10.0
Goods and services	2.6	2.3	2.2	2.8	0.7	0.9	3.6
Pensions	17.4	17.4	16.6	16.7	4.4	4.4	17.8
Private sector transfers	6.4	6.2	5.8	8.8	2.6	2.9	11.2
Capital	1.0	0.7	0.6	0.5	0.2	0.4	1.5
Provincial transfers	17.8	18.0	17.0	17.2	4.2	4.3	20.9
Primary cash balance	**1.1**	**2.7**	**0.2**	**2.2**	**1.8**	**1.5**	**10.0**
Interest 2/	8.2	9.7	12.0	33.2	2.6	19.1	58.7
Overall balance	-7.2	-7.0	-11.8	-30.9	-0.8	-17.6	-48.7
Memorandum items:							
Other debt creating expenditures	1.9	1.6	1.6	38.1	0.6	7.1	27.7
Of which: bonds issued to assist banks 3/	0.0	0.0	0.0	36.0	0.0	0.0	9.0
Interest arrears	0.0	0.0	0.0	12.8	3.3	3.4	17.3
Augmented primary surplus	-0.8	1.1	-1.4	-35.9	1.2	-5.6	-17.7
Augmented overall balance	-9.0	-8.5	-13.4	-81.9	-4.7	-28.0	-93.7
	(In percent of period GDP)						
Revenues	19.4	19.6	18.7	17.8	18.2	17.4	19.7
Tax revenues	13.6	14.3	13.8	13.2	13.5	12.7	15.3
Social security contributions	3.8	3.7	3.6	3.1	3.2	3.0	3.0
Nontax revenues	1.9	1.6	1.3	1.6	1.4	1.8	1.4
Primary expenditure	19.0	18.6	18.6	17.1	16.2	15.9	17.1
Primary expenditure (excl. provincial transfers)	12.7	12.3	12.3	11.7	11.4	11.4	11.7
Of which:	3.0	3.0	2.9	2.5	2.6	2.3	2.6
Wages	0.9	0.8	0.8	0.9	0.8	0.9	0.9
Goods and services	6.2	6.1	6.2	5.3	4.9	4.6	4.6
Pensions	2.3	2.2	2.2	2.8	2.9	3.0	2.9
Capital	0.3	0.2	0.2	0.2	0.2	0.4	0.4
Provincial transfers	6.3	6.3	6.3	5.4	4.7	4.5	5.4
Primary cash balance	**0.4**	**0.9**	**0.1**	**0.7**	**2.0**	**1.6**	**2.6**
Interest	2.9	3.4	4.5	10.5	2.9	20.0	15.1
Overall balance	-2.5	-2.4	-4.4	-9.8	-0.9	-18.4	-12.5
Augmented primary surplus	**-0.3**	**0.4**	**-0.5**	**-11.3**	**1.4**	**-5.8**	**-4.5**
Augmented overall balance	-3.2	-3.0	-5.0	-25.8	-5.2	-29.3	-24.0

Source: Ministry of Economy of Argentina.

1/ Includes BCRA profit transfers.

2/ In 2002-03, excludes interest due on unrestructured debt (phase two), but includes the cost of inflation indexation.

3/ Includes bonds issued to banks in connection with banking crisis, the reinstatement of wage and pension cuts implemented in July 2001, and bonds issued to depositors in connection with the opening of the *corralón*.

Table 4. Argentina: Federal Government Tax Revenue, 2002-03

	2002			Jan-Mar 2003	
	H1	H2	Year	Actual	Prog.
	(In billions of pesos)				
Total Revenue	**21.8**	**28.7**	**50.5**	**15.8**	**15.5**
Tax Revenue	**18.0**	**24.2**	**42.3**	**13.0**	**12.7**
Income tax	3.7	5.2	8.9	2.7	2.0
VAT	6.9	8.4	15.2	4.5	4.8
Fuel taxes	1.9	1.6	3.5	1.1	1.1
Financial transaction tax	2.2	2.6	4.9	1.3	1.3
Trade taxes	1.9	4.4	6.3	2.4	2.6
Export tax	1.4	3.7	5.0	2.0	2.1
Import tariffs	0.5	0.8	1.3	0.4	0.5
Other taxes	1.4	2.0	3.5	0.9	0.9
Social security contributions	**3.8**	**4.4**	**8.2**	**2.8**	**2.8**
	(12-month percent change)				
Total Revenue	**-9.6**	**34.7**	**11.2**	**58.0**	**55.3**
Tax Revenue	**-9.3**	**38.9**	**13.2**	**171.0**	**167.0**
Income tax	-35.5	20.4	-11.6	70.6	30.3
VAT	-19.9	23.7	-0.7	47.8	55.0
Fuel taxes	24.4	-14.8	3.1	17.3	19.1
Financial transaction tax	...	21.6	65.6	36.2	31.7
Import tariffs	-43.8	17.4	-17.8	96.5	137.9
Social security contributions	**-10.8**	**15.5**	**114.0**	**47.1**	**48.1**

Source: Ministry of Economy.

Table 5. Argentina: Provincial Government Operations, 1998-2003

	1998	1999	2000	2001	Prel. 2002	Q1 Prog. 2003	Q1 Prel. 2003	Prog. 2003
	(In billions of pesos)							
Revenue	**32.8**	**31.8**	**32.5**	**29.9**	**30.8**	**7.9**	**8.8**	**38.8**
Own revenue	14.5	14.0	14.5	12.9	13.5	3.6	4.6	17.9
Taxes	11.7	11.0	10.9	9.8	9.7	2.6	3.5	12.8
Nontaxes	2.8	2.9	3.6	3.2	3.8	1.1	1.0	5.1
Transfers from federal government	18.3	17.8	18.0	17.0	17.2	4.3	4.2	20.9
Primary expenditures 1/	**33.9**	**35.0**	**34.0**	**34.0**	**32.3**	**7.6**	**8.4**	**36.7**
Personnel	16.8	18.0	18.6	18.8	17.9	4.7	4.3	20.5
Other	17.0	16.9	15.4	15.2	14.4	2.9	4.0	16.2
Goods and services	3.8	4.1	3.7	3.9	3.7	0.6	1.0	4.1
Private sector transfers	3.1	3.4	3.2	3.2	3.2	0.7	0.9	3.5
Transfers to municipalities	4.9	4.8	4.9	4.8	4.6	1.1	1.4	5.7
Other (capital)	5.2	4.7	3.6	3.3	2.9	0.5	0.7	2.9
Primary balance (commitment)	**-1.1**	**-3.1**	**-1.5**	**-4.0**	**-1.6**	**0.3**	**0.4**	**2.1**
Interest (cash) 2/	1.2	1.4	1.9	2.4	1.5	0.7	0.3	3.2
Net arrears reduction (-, accumulation)	0.0	0.0	0.0	0.0	1.3	...	...	...
Cash balance	-2.3	-4.6	-3.3	-6.5	-4.3	-0.4	0.2	-1.1
Interest capitalization	0.0	0.0	0.0	0.0	10.6	...	...	12.5
Overall balance	-2.3	-4.6	-3.3	-6.5	-14.9	-0.4	0.2	-13.6
Interest arrears	0.0	0.0	0.0	0.0	1.6	...	...	4.9
Augmented balance	-2.3	-4.6	-3.3	-6.5	-16.5	-0.4	0.2	-18.4
	(In percent of GDP)							
Revenue	**11.0**	**11.2**	**11.4**	**11.1**	**9.1**	**8.2**	**9.8**	**9.8**
Own revenue	4.8	4.9	5.1	4.8	4.0	3.8	5.1	4.5
Taxes	3.9	3.9	3.8	3.6	2.9	2.7	3.9	3.2
Nontaxes	0.9	1.0	1.3	1.2	1.1	1.1	1.2	1.3
Transfers from federal government	6.1	6.3	6.3	6.3	5.1	4.5	4.7	5.3
Primary expenditures 1/	**11.3**	**12.3**	**12.0**	**12.6**	**9.5**	**7.9**	**9.3**	**9.3**
Personnel	5.6	6.4	6.5	7.0	5.3	4.9	4.8	5.2
Other	5.7	6.0	5.4	5.7	4.3	3.0	4.5	4.1
Primary balance (commitment)	**-0.4**	**-1.1**	**-0.5**	**-1.5**	**-0.5**	**0.3**	**0.5**	**0.5**
Interest (cash) 2/	0.4	0.5	0.7	0.9	0.4	0.7	0.3	0.8
Net arrears reduction (-, accumulation)	0.0	0.0	0.0	0.0	0.4	...	...	...
Cash balance	-0.8	-1.6	-1.2	-2.4	-1.3	-0.4	0.2	-0.3
Interest capitalization	0.0	0.0	0.0	0.0	3.1	...	...	3.2
Overall balance	-0.8	-1.6	-1.2	-2.4	-4.4	-0.4	0.2	-3.4
Interest arrears	0.0	0.0	0.0	0.0	0.5	...	...	1.2
Augmented balance	-0.8	-1.6	-1.2	-2.4	-4.9	-0.4	0.2	-4.7

Sources: Ministry of Economy; and Fund staff estimates.

1/ Expenditures on a commitments basis.

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

Table 6. Argentina: Net Debt Service to the IFIs, January-August 2003

(In millions of U.S. dollars)

	Jan.-May		June-Aug.		Jan.-Aug.
	Program	Estimate	Program	Revised 1/	Program
IMF 2/					
A. Debt service	4,851	4,841	1,702	1,686	6,553
B. Disbursements and extensions of repurchase expectations	4,746	4,446	1,807	2,107	6,553
C. Net debt service (A-B)	105	395	-105	-421	0
World Bank					
A. Debt service	2,034	1,777	203	201	2,237
B. Disbursements	1,412	1,153	818	1,077	2,230
C. Net debt service (A-B)	622	624	-615	-876	7
IDB					
A. Debt service	1,048	1,030	943	1,068	1,991
B. Disbursements	1,216	1,100	965	1,081	2,181
C. Net debt service (A-B)	-168	-70	-22	-13	-190

Sources: IMF; World Bank; IDB staff; and authorities' data.

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

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

Table 7. Argentina: Selected Economic and Financial Indicators, 1998-2003

	1998	1999	2000	2001	2002	Proj. 2003
(Annual percentage changes; unless otherwise indicated)						
National income and prices						
GDP at constant prices	3.8	-3.4	-0.8	-4.4	-10.9	4.0
Consumer prices (average)	0.9	-1.2	-0.9	-1.1	25.9	20.0
Consumer prices (end-of-period)	0.7	-1.8	-0.7	-1.5	41.0	15.4
Social indicators						
Population below poverty line (in percent)	24.3	27.1	29.7	35.4	49.7	...
Population below extreme poverty line (in percent)	5.3	7.6	7.5	12.2	22.7	...
External sector						
Exports, f.o.b. (in terms of U.S. dollars)	1.0	-11.8	13.3	0.8	-4.7	7.7
Imports, c.i.f. (in terms of U.S. dollars)	3.1	-18.8	-1.0	-19.5	-55.8	30.4
Export volume	11.6	-0.7	2.7	4.6	-0.3	3.6
Import volume	8.7	-13.9	-0.9	-17.3	-54.5	26.5
Terms of trade (deterioration -)	-5.5	-5.9	10.2	-0.6	-1.1	-8.5
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/						
Net domestic assets of the financial system	17.1	8.9	-1.3	1.3	73.7	-2.6
Of which: credit to private sector	12.4	-2.3	-3.8	-17.6	-21.8	-12.1
Broad money	13.1	3.2	3.2	-19.7	17.0	14.5
Income velocity of broad money 2/	0.3	0.3	0.3	0.3	0.4	0.3
Interest rate (30-day deposit rate, in percent)	7.6	8.0	8.3	16.2	41.8	...
(In percent of GDP)						
Public sector savings	-0.5	-2.6	-2.2	-5.6	-9.6	-11.7
Consolidated public sector primary balance	0.5	-0.8	0.1	-1.4	0.5	3.1
Of which: Federal government	0.9	0.4	0.9	0.1	0.7	2.6
Consolidated public sector overall balance	-2.1	-4.2	-3.9	-6.8	-10.6	-12.9
Revenues	23.7	24.3	24.3	23.5	22.4	24.2
Expenditures	25.8	28.5	28.1	30.3	33.0	37.1
Of which: interest expenditures	2.6	3.4	4.0	5.4	11.1	15.9
Gross domestic investment	19.9	18.0	16.2	14.2	12.0	13.7
Gross national savings	15.2	13.8	13.1	12.5	20.9	20.8
Current account balance	-4.8	-4.2	-3.1	-1.7	8.8	7.7
Public sector total debt (end-of-year)	37.6	43.0	45.0	53.8	149.1	132.0
Public sector external debt (end-of-year)	27.8	29.9	29.9	32.9	95.8	65.1
(In percent of exports of goods and nonfactor services; unless otherwise indicated)						
Public sector external debt service	37.8	49.4	54.8	65.0	50.0	69.2
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/ Based on June 2002 data for financial sector and March 2003 data for BCRA. Foreign currency items in projections are valued at the March 2003 exchange rate of Arg$2.9 per U.S. dollar.
2/ Measured in terms of monthly GDP.
3/ In months of imports of goods and nonfactor services.

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

	1998	1999	2000	2001	2002	Proj. 2003
	(In billions of U.S. dollars)					
Current account	**-14.5**	**-11.9**	**-8.8**	**-4.5**	**9.0**	**7.7**
Trade balance	-5.0	-2.2	1.2	6.3	16.4	15.6
Exports f.o.b.	26.4	23.3	26.4	26.6	25.4	27.3
Of which: oil products (net)	1.6	2.3	3.9	3.9	3.9	4.1
Imports c.i.f.	-31.4	-25.5	-25.2	-20.3	-9.0	-11.7
Services and transfers	-9.6	-9.7	-10.0	-10.8	-7.4	-7.9
Of which: net interest payments	-5.1	-5.9	-5.9	-7.4	-6.9	-7.1
Capital and Financial Account	**18**	**14**	**8**	**-16**	**-25**	**-27**
Net public sector capital	9.5	10.6	8.1	-2.1	-6.4	-6.6
Direct investment	4.6	7.2	8.4	3.4	2.1	0.4
Other net private sector capital 1/	4.3	-3.9	-8.7	-17.8	-21.2	-20.9
Overall balance	**3.9**	**2.1**	**-1.0**	**-20.9**	**-16.5**	**-19.5**
Financing	**-3.9**	**-2.1**	**1.0**	**20.9**	**16.5**	**19.5**
Net international reserves (increase -) 2/	-3.9	-2.1	1.0	20.9	4.8	-6.3
Change in gross reserves	-3.4	-1.1	0.4	12.0	4.4	-3.7
Change in reserve liabilities (IMF)	0.4	1.0	-0.6	-8.9	-0.4	2.7
Exceptional financing	0.0	0.0	0.0	0.0	11.7	25.8
Arrears	0.0	0.0	0.0	0.0	11.7	19.4
Rescheduling	...	...	...	...	...	0.9
Other 3/	...	...	...	...	...	5.5
	(In percent of GDP, unless otherwise specified)					
Current account	**-4.9**	**-4.2**	**-3.1**	**-1.7**	**8.8**	**5.8**
Trade account	-1.7	-0.8	0.4	2.3	16.1	11.8
Exports, f.o.b.	8.8	8.2	9.3	9.9	25.0	20.8
Of which: oil products (net)	0.5	0.8	1.4	1.5	3.8	3.1
Imports c.i.f.	-10.5	-9.0	-8.9	-7.6	-8.8	-8.9
External debt	**47.5**	**51.2**	**51.6**	**52.2**	**132.2**	**101.1**
Of which: public sector	27.8	29.9	29.9	32.9	95.8	65.1
External debt service ratio 4/	**76.1**	**100.3**	**105.0**	**108.3**	**108.1**	**114.0**
Of which : public sector debt	37.8	49.4	54.8	65.0	50.0	69.2
Memorandum items:						
Exports volumes, percent change	11.6	-0.7	2.7	4.6	-0.3	3.6
Imports volumes, percent change	8.7	-13.9	-0.9	-17.3	-54.5	26.5
Net international reserves 2/ 5/	6.8	8.7	8.3	0.4	-3.8	1.9
(in millions of U.S. dollars) 2/	20.8	22.9	21.9	0.9	-3.9	2.5
LIBOR (6 months U.S. dollar deposits)	5.6	5.5	6.6	3.7	1.9	1.7

Sources: Ministry of Economy and Fund staff estimates.

1/ Includes errors and omissions.

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

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

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

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

Table 9. Argentina: External Financing Requirements and Sources, 2001-03
(in billions of U.S. dollars)

	2001	2002	2003
Gross financing requirements	58.8	32.1	33.2
Current account deficit	4.5	-9.0	-7.7
Capital outflows	54.3	41.1	40.9
Public sector amortization	21.2	7.9	16.7
IMF	1.2	0.8	5.6
Multilateral loans	0.9	2.2	3.8
Official bilateral creditors	0.5	0.5	0.7
Bonds and notes	7.2	3.1	5.8
Other	11.5	1.3	0.7
Private sector amortization	17.0	20.0	10.8
Other private sector flows, net (+outflows) 1/	16.1	13.3	13.4
Available financing	58.8	32.1	19.4
Capital inflows	46.8	27.7	23.1
Foreign direct investment	3.4	2.1	0.4
Disbursements to public sector	28.1	0.7	0.0
Private sector borrowing	15.3	13.2	3.3
Exceptional financing	0.0	11.7	19.4
Public sector arrears accumulation	0.0	8.0	9.2
Private sector arrears accumulation	0.0	3.7	10.3
Gross reserves accumulation (- increase)	12.0	4.4	-3.7
Financing gap	0.0	0.0	13.8
Transitional program	...	...	7.4
IMF	...	...	3.0
World Bank	...	...	2.2
IDB	...	...	2.2
Rescheduling	...	...	0.9
Residual financing gap	...	...	5.5

Sources: BCRA; and Fund staff estimates.

1/ Includes errors and omissions.

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

(In billions of pesos, end of period)

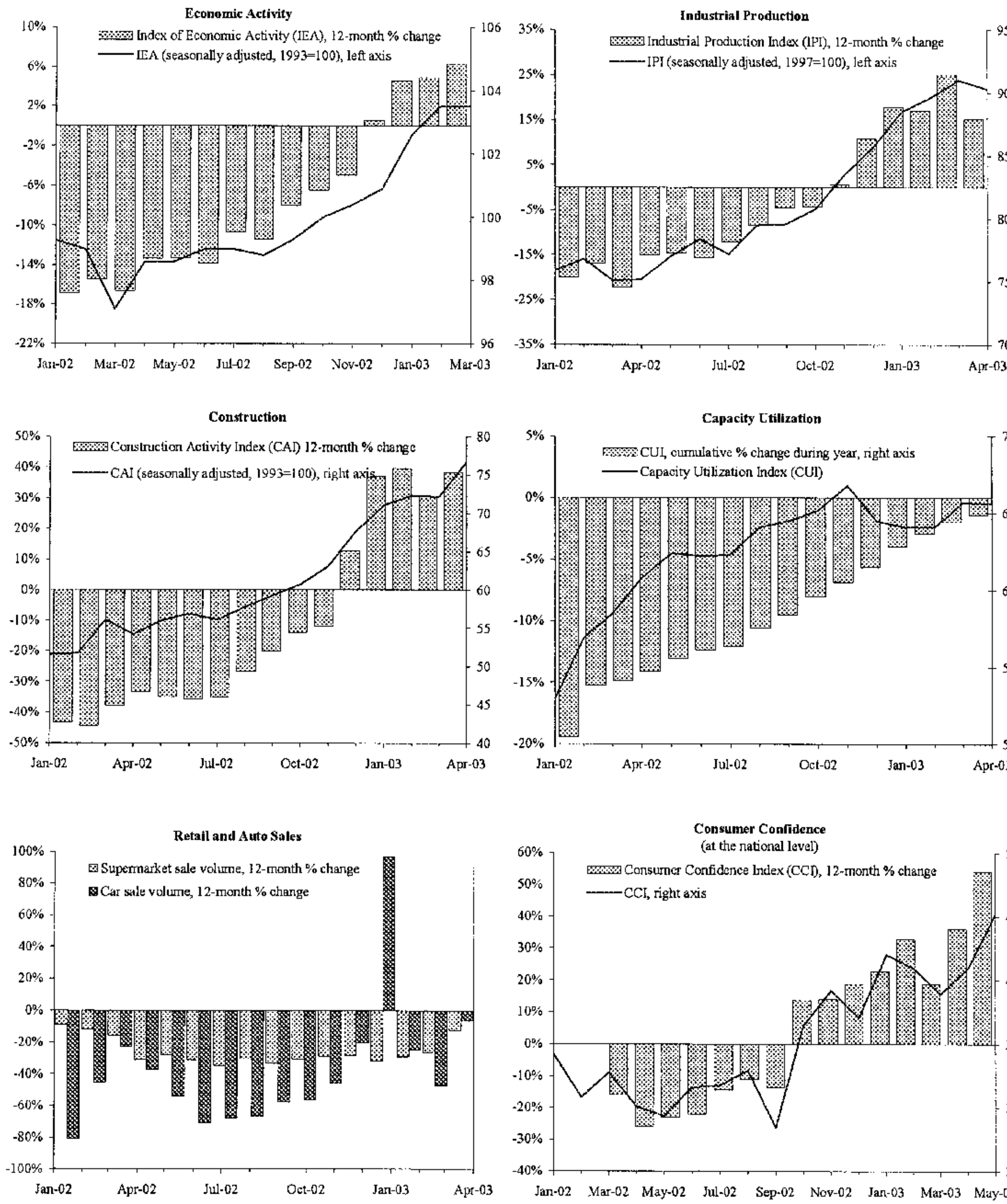
	1998	1999	2000	2001	Est. 2002	Apr 2003	Proj. 2003
		I. Central Bank					
Net international reserves 2/	13.1	13.4	12.5	3.2	-17.0	-13.9	-7.3
Net domestic assets	3.3	3.1	2.5	8.7	46.1	45.4	45.2
Credit public sector (net)	5.6	5.3	5.3	12.3	54.1	48.5	47.3
Credit to the financial sector (net)	1.5	1.3	1.0	-0.9	22.4	22.0	22.8
Official capital and surplus and other assets (net)	-3.7	-3.5	-3.7	-2.7	-30.4	-25.1	-24.9
Monetary base	16.4	16.5	15.1	11.9	29.2	31.5	38.0
Currency issued	16.4	16.5	15.1	11.0	18.8	19.8	26.0
Bank deposits at the central bank (in pesos)	...	...	...	0.9	10.3	11.6	11.9
		II. Banks and Nobank Financial Institutions					
Net foreign assets	1.5	-2.1	2.4	-6.2	-27.6	-21.9	-19.2
Net domestic assets	66.0	72.0	71.3	66.4	92.2	90.2	90.2
Credit to public sector (net)	14.2	18.8	19.7	24.1	76.3	70.8	70.8
Credit to private sector	72.2	70.6	67.9	56.0	43.7	39.7	38.8
Claims on central bank (net)	3.5	3.8	3.5	4.7	-10.3	-9.4	-9.8
Capital and reserves	-17.0	-16.9	-17.3	-16.5	-21.6	-16.8	-14.4
Other	-6.8	-4.3	-2.5	-1.9	4.1	5.8	4.8
Private sector deposits	67.5	69.9	73.7	60.2	64.6	68.3	71.0
Local currency	28.1	26.7	26.0	15.9	63.0	66.3	68.7
Foreign currency	39.4	43.2	47.7	44.2	1.7	2.0	2.3
		III. Consolidated Financial System					
Net foreign assets	14.6	11.3	14.9	-3.0	-44.5	-35.8	-26.5
Net domestic assets	66.4	72.3	71.4	72.3	125.6	121.7	121.2
Credit to public sector (net)	19.7	24.1	25.0	36.4	130.4	119.3	118.1
Credit private sector	72.2	70.6	67.9	56.0	43.7	39.7	38.8
Net capital, reserves, and other assets	-25.5	-22.4	-21.5	-20.1	-48.6	-37.3	-35.7
Liabilities to private sector (broad money)	81.0	83.6	86.3	69.3	81.0	85.9	94.7
Currency in circulation	13.5	13.7	12.6	9.1	16.4	17.6	23.7
Local currency deposits	28.1	26.7	26.0	15.9	63.0	66.3	68.7
Foreign currency deposits	39.4	43.2	47.7	44.2	1.7	2.0	2.3
Memorandum items:							
Stock of central bank paper (Lebacs)	...	...	...	...	3.2	4.3	4.5
		(Annual Percent Change)					
Base money	2.5	0.7	-8.7	-21.0	145.1	47.9	30.2
Broad money	13.1	3.2	3.2	-19.7	17.0	15.0	16.9
Credit to private sector	12.4	-2.3	-3.8	-17.6	-21.8	-22.8	-11.4

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

1/ Based on BCRA data up to April 2003 and financial system data up to June 2002. Foreign currency items in projections are valued at the April 2003 exchange rate of Arg$2.855 per U.S. dollar.

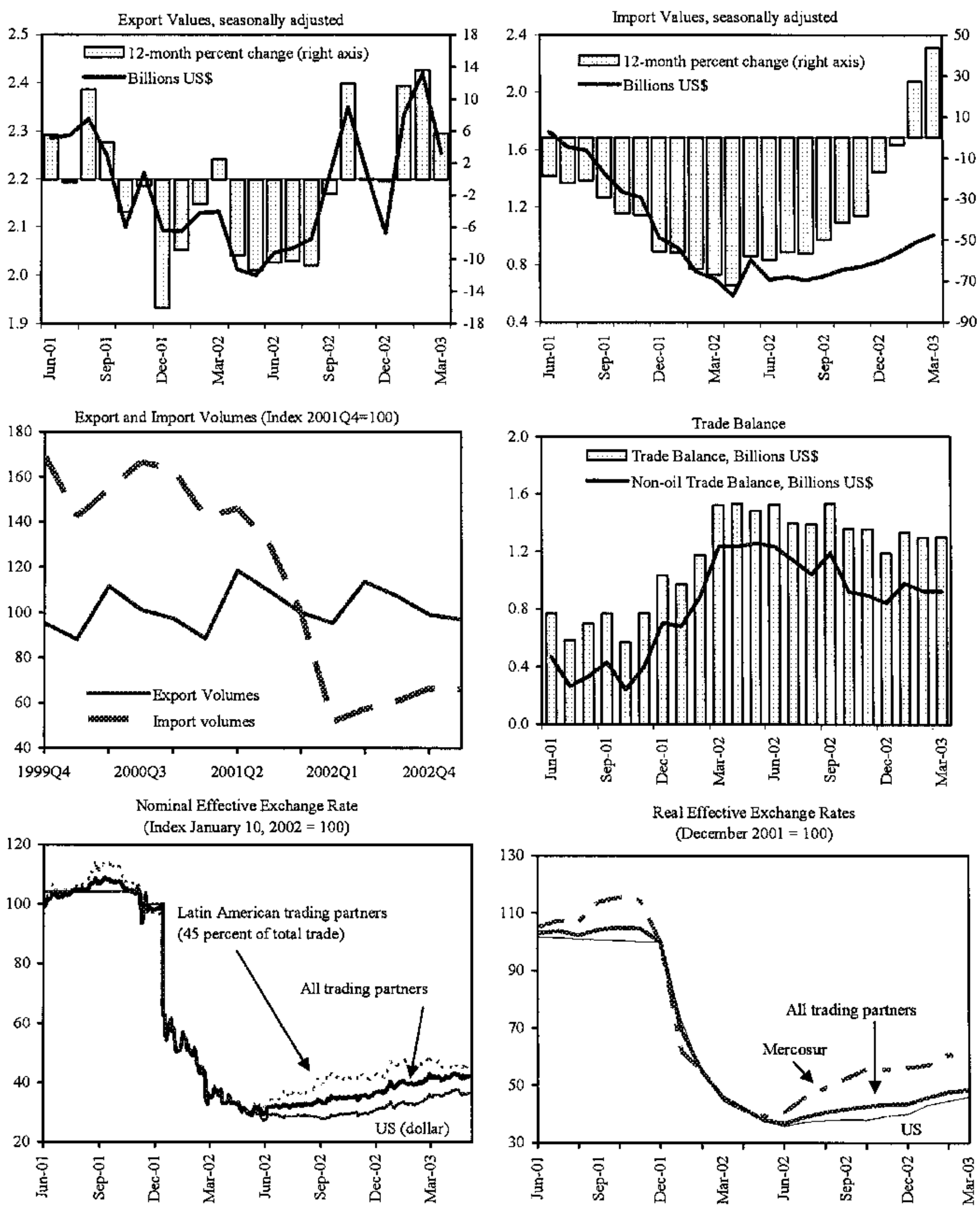
2/ Foreign liabilities include only liabilities to the IMF. Historical gross reserve numbers have been revised from previous versions to exclude foreign currency securities repoed by BCRA to banks.

Figure 1. Argentina: Indicators of Real Activity



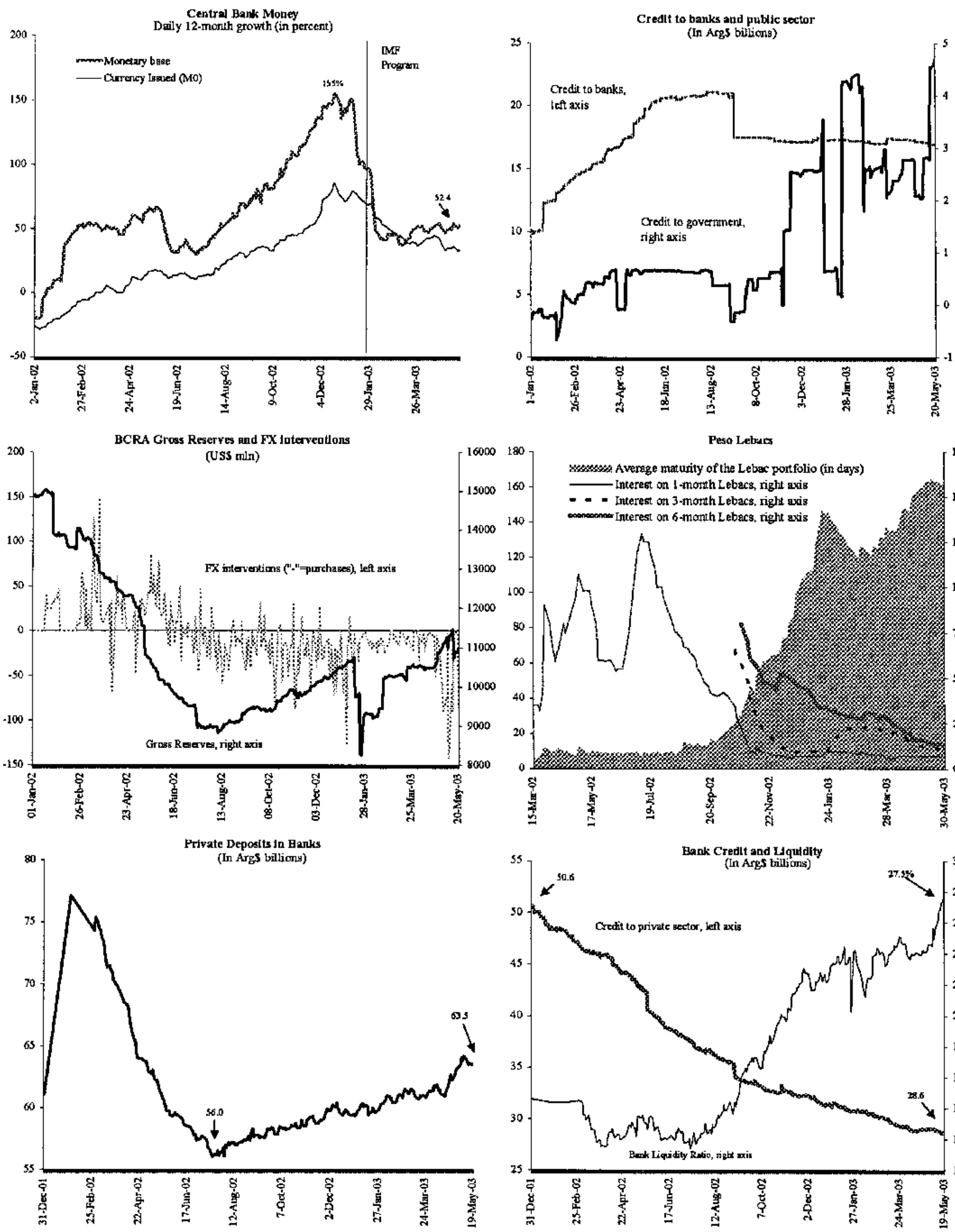
Source: Ministry of Economy of Argentina and INDEC.

Figure 2. Argentina: External Sector Developments



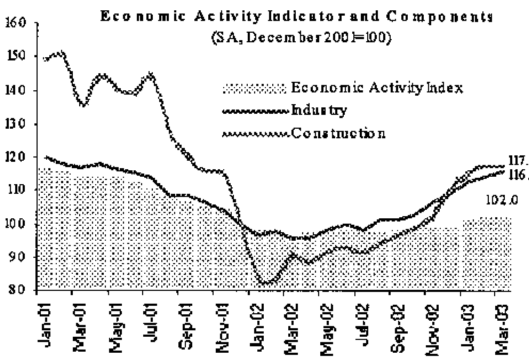
Source: Argentina Ministry of Finance and staff estimates

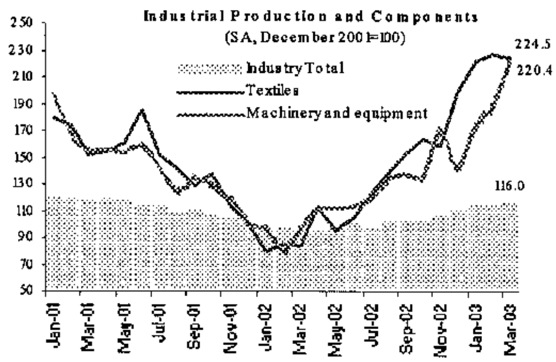
Figure 3. Argentina: Recent Monetary Developments



ARGENTINA—THE EMERGING RECOVERY

After a sluggish start in mid-2002, the pace of economic recovery picked up in early 2003 (text figures). The economic activity indicator (the monthly proxy for GDP) increased by 2.8 percent quarter-over-quarter in 2003Q1 (seasonally adjusted), compared to a 1.4 percent in 2002Q4 and only 0.3 percent in 2002Q3.





On the supply side, industry and agriculture are spearheading the recovery, as many of their outputs are import-substitutes or exportables, and have benefited from the large real depreciation of the *peso*.

- **Industrial production** (15 percent of GDP) grew in the first quarter by about 8 percent from the previous quarter and by 18 percent from the same quarter last year. Growth was driven by the sectors whose products are increasingly used as import substitutes, namely textiles (year-on-year growth of 170 percent in the first quarter) and production of machinery and equipment (growth of 113 percent). Lagging behind are the sectors oriented toward domestic demand, including beverages, milk, tobacco and meat, many of which still register negative year-on-year growth rates.

- **Agriculture** (6 percent of GDP), whose outputs are largely exported, also appears to be growing rapidly. Exports of agricultural goods grew by 35 percent (in volume terms) in the first quarter compared to the same period last year, and were the only export item to register positive year-on-year growth.

- **Construction** (4 percent of GDP) has rebounded sharply since mid-2002, driven largely by the family homes segment. Benefiting from these developments, the cement industry is now one of the fastest growing industrial sectors.

- **Services** (66 percent of GDP), which are largely oriented toward domestic demand, appear to be recovering more slowly, affected by the drop in the relative price of nontradables, depressed real incomes, and the banking crisis. Anecdotal evidence, however, suggests that spill-over effects from industry and agriculture are boosting transportation activities and trade services, while hotels and restaurants are benefiting from a higher influx of tourists following the depreciation of the *peso*.

Domestic demand is also recovering, driven by both consumption and investment.

- **Investment** (12 percent of GDP), comprising construction (⅔ of total) and machinery and equipment (⅓), appears to be recovering faster than consumption, as suggested by the rapid rebound in construction and machinery and equipment production. Confirming these trends, the imports of spare parts and intermediate goods are growing at annual rates of 26–28 percent, by far the fastest growing import items. The sectors that are now the fastest growing—textiles, machinery production—were among the most depressed in the 1990s, and undertook little investment. The recovery in agriculture has also boosted demand for machinery and equipment.

- **Consumption** (73 percent of GDP) appears to be recovering as well—though the evidence is less clear. On the positive side, the volume of retail sales, VAT collections, and car sales are increasing at annual rates of 10–20 percent. However, imports of consumer goods are still 18 percent below their early 2002 levels (in real terms) and real incomes remain compressed.

- **The recovery of net exports appears to be loosing steam**, as overall import growth has picked up significantly, while exports have stalled. For the year as a whole, net exports are not expected to add to GDP growth.

Overall, recent developments point to a relatively robust recovery. For 2003, real GDP is expected to grow by at least 4 percent, compared to a 10.9 percent decline in 2002. When compared to other crisis episodes, Argentina's projected recovery from the crisis is in line with the median in other countries, although the contribution of net exports is weaker (see text table).

Contribution to GDP Growth in Selected Crisis Episodes

		Year *t*				Year *t+1*			
			Contribution to GDP growth				Contribution to GDP growth		
Country	(Year *t*)	GDP Growth	Private Consumption	Fixed Investment	Net Exports	GDP Growth	Private Consumption	Fixed Investment	Net Exports
Argentina	(2002)	**-10.9**	**-10.5**	**-5.7**	**6.0**	**4.0**	**4.1**	**1.1**	**-0.1**
Median		**-6.5**	**-5.1**	**-6.5**	**6.7**	**4.8**	**2.7**	**1.1**	**0.6**
Mexico	(1995)	-6.2	-6.9	-5.6	8.5	5.2	1.5	2.4	-0.3
Brazil	(1999)	0.5	-0.9	-1.5	2.3	4.4	3.2	1.0	-0.2
Russia	(1998)	-4.9	-2.2	-1.1	4.1	5.4	0.5	1.1	6.5
Indonesia	(1998)	-13.1	-3.9	-10.6	4.8	0.8	3.2	-4.8	3.0
Korea	(1998)	-6.7	-6.2	-7.3	12.3	10.9	5.6	1.1	-0.8
Thailand	(1998)	-10.8	-6.2	-15.2	12.6	4.3	2.2	-0.8	1.4

Sources: WEO database; and staff estimates.

ARGENTINA—THE STRATEGY FOR THE EARLY REDEMPTION OF QUASI-MONIES[1]

On May 8, 2003, congress approved legislation setting out the terms and conditions for the redemption of federal and provincial quasi-monies. The legislation provides for a one-time change in the central bank charter that would permit the central bank to accept government bonds at face value, and not at market value, as currently required. The current stock of quasi-monies is about Arg$7.8 billion, of which Arg$4.5 billion was issued by provinces and the remaining Arg$3.3 billion by the federal government (the *lecops*).

The main features of the redemption of *provincial* quasi-monies are:

- **Participation of the provinces is optional.** Thus far, seven provinces (Catamarca, Corrientes, Córdoba, Chaco, Entre Ríos, Formosa, and Tucumán), holding over 39 percent of all provincial quasi-monies, had agreed to participate in the redemption scheme.[2] However, the authorities expect that all provinces will eventually participate, and that all quasi-monies issued in 2001–02 will be redeemed by end-2003.

- **The redemption will be done at close to market value through an auction of *pesos* for quasi-monies.** The central bank will host the auction and the ministry of economy will determine the cut-off price, as well as which bids are successful.

- **The auction will be structured in five tranches**: (i) primary auctions, for amounts up to 60 percent of the total quasi-monies issued in each province; (ii) secondary auctions (for smaller amounts), in which offers will be accepted at the price obtained in the primary auction less a discount of 5 percent; (iii) holders of up to Arg$500 of quasi-monies will be able to redeem them at the price obtained in the primary auction; (iv) quasi-monies held in federal, provincial and municipal treasuries will be redeemed at par (to avoid the emergence of financing gaps); and (v) public sector workers and pensioners will redeem their holdings of quasi-monies at par (up to the amount of wages or pensions paid in quasi-monies during the previous month).

- **Provinces will not be bailed-out.** The federal government will place bonds at the central bank with a face value equal to the amount of *pesos* needed for the redemption; it will then lends *pesos* to the provinces, with the provinces assuming an obligation to the federal government on the same terms as the bonds. With respect to the terms, the

[1] Background information on the emergence of quasi-monies can be found in EBS/02/214, Argentina—Staff Report for the 2002 Article IV Consultation, December 17, 2002, page 34.

[2] Quasi-monies were issued in 12 out of the 24 provinces in the course of 2001–02.

provinces can choose between those of the 2007 and 2012 *Bodens* (the bonds issued in connection with the banking crisis.[3]

- **Provincial governments must make several commitments to participate in the scheme**: (i) pledge their coparticipation transfers to guarantee servicing their obligations under the redemption; (ii) refrain from issuing quasi-monies in the future; (iii) ban the use of quasi-monies for the payment of provincial taxes; and (iv) agree to convert into a noninterest bearing three-year bullet bond all the quasi-monies that are not exchanged for *pesos*.

The main features of the redemption of *federal* quasi-monies (*lecops*) are:

- **The redemption of *lecops* will take place over 5–6 months, and will be at face value**. The *lecops* received by the federal tax administration's (AFIP) account in the state bank Banco de la Nación will be exchanged for *pesos* at face value at the end of each week.

- **The federal government will borrow *pesos* from the central bank to finance the redemption**. As in the case of provincial quasi-monies, the federal government has the option to place at the central bank a bond (2007 or 2012 *Boden*) with a face value equal to the amount of *lecops* issued.

A few provinces (Mendoza, La Rioja, and San Luis), representing less than 5 percent of the total stock of quasi-monies, have decided not to join the redemption scheme. The province of Mendoza will finance the redemption through higher-than-budgeted oil royalties, while the provinces of La Rioja and San Luis have still to clarify their position.

The redemption of quasi-monies should have no significant impact on the monetary program, as most of them trade at close to par with the *peso*, and are included in the program definition of base money. However, the stock of debt will increase, reflecting the increase in the obligations of the federal government to the central bank.

[3] The 2007 *Bodens* are *peso*-denominated, carry 2 percent interest rate with principal indexed to inflation, and begin amortizing in 2003; the 2012 *Bodens* are U.S. dollar-denominated, carry the libor, and amortize from 2005.

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

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

A. Financial Relations

II. General Resources Account:	In millions SDRs	In percent of Quota
Quota	2,117.10	100.00
Fund holdings of currency	12,724.72	601.04
Reserve position in Fund	0.02	0.00

III. SDR Department:	In millions of SDRs	Percent of Allocation
Net cumulative allocation	318.37	100.00
Holdings	736.31	231.27

IV. Outstanding Purchases and Loans:	In millions of SDRs	In percent of Quota
Stand-By Arrangements	9,988.53	471.80
Extended Fund arrangements	619.11	29.24

V. Latest Financial Arrangements

			SDR Millions	
Type	Approval Date	Expiration Date	Amount Approved	Amount Drawn
Stand-By	01/24/03	08/31/03	2,174.50	973.20
Stand-By	03/10/00	01/23/03	16,936.80	9,756.31
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	3,876.42	4,971.15	1,130.47	507.95	121.65
Charges/interest	327.31	141.09	31.29	10.34	0.85
Total	4203.73	5,112.23	1,161.76	518.29	122.5

VII. Safeguards Assessments: Under the Fund's safeguards assessment policy, the Central Bank of Argentina (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 to be implemented during the current arrangement include: (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 the third review. On the former, the authorities informed the staff that they have initiated work for the presentation of the 2003 BCRA accounts according to IAS. 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 l, 1992 the peso was substituted for the austral at a rate of l peso per 10,000 australes. On January 7, 2002, the currency board arrangement was abandoned in favor of a dual exchange rate regime with an official rate of Arg$1.4 per U.S. dollar for most trade, trade finance, and public sector transactions; remaining transactions were at a market floating rate. On February 11, 2002, the dual exchange rate regime was abolished and substituted by a managed floating regime with no pre-announced rate of the exchange rate.

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

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

XI. Technical Assistance, 2002

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

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

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

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

On December 13, 2002, Argentina failed to become current on all payments to the Bank, and consequently the Bank suspended, effective December 14, 2002, the borrower's rights to

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

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.

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

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

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

Financial Relations with the World Bank

(In millions of U.S. dollars)

I. IBRD Operations (as of May 31, 2003)

		Commitments (Net of Calculations)	Disburse-ments	Undisbursed Amount
Fully disbursed loans		**14,296.1**	**14,296.1**	**0.0**
Loans in process of disbursement		**3,978.8**	**2,258.4**	**1,720.6**
A. Investment operations				
Agriculture and rural development		251.6	91.7	159.9
Power		30.0	2.2	27.8
Municipal/provincial development		432.1	380.7	51.4
Water sector		30.0	3.6	26.5
Social sector		1,289.3	719.1	570.2
Finance, infrastructure, and natural resources	1,192.2	639.9	552.2	
Public administration		50.80	14.2	36.6
B. Adjustment operations		703. 0	407.00	296.00
Total loans		**18,274.9**	**16,554.5**	**1,720.6**

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

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

III. IBRD Loan Transactions

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

Source: World Bank.

1/ Includes repayment from third parties.

ARGENTINA—RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK[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 policy reforms.

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

3. In a second stage, work is underway on a proposal to redirect resources from active projects that are unlikely to make progress again soon to initiatives that help revitalize economic activity and improve the competitiveness of the productive sectors. This revitalization package would total US$400 million.

4. In early 2003 the second tranche of two sector loans have been reformulated in order to adapt to the new reality in Argentina: the Financial Sector Program in the amount of US$243 million, and the Sector Program to Support the Federal Pact for Growth and Fiscal Discipline in the amount of US$246.7 million. Each of these second tranches were split into two having already been disbursed the first part of each of them.

5. As of June 1, 2003 disbursements for the year totaled US$1.1 billion with US$1.8 billion remaining to be disbursed during the rest of the year.

[1] Prepared by the staff of the IDB.

Lending Program and Country Strategy

1. Under the Transition Program agreed with the IMF, on February 5, 2003 an **emergency loan** of US$1.5 billion was approved to protect social expenditure. The first tranche of US$765 million was disbursed upon approval and the second and last tranche is expected to be disbursed by the end of June. Once priorities are discussed with the new government elected in May 2003 and a new agreement is reached between the IMF and the new government, an additional emergency loan in the amount of US$1 billion could be approved.

2. Additionally, two direct loans to the provinces of Salta and Río Negro will be considered for 2003 with the main objective to revitalize economic growth by supporting sectors with greater comparative advantages.

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

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

5. The Bank's new strategy for action in Argentina is expected to be prepared and discussed with the new government in 2003 and approved by early 2004.

Buenos Aires, Argentina
June 13, 2003

Mr. Horst Köhler
Managing Director
International Monetary Fund

Dear Mr. Köhler:

1. We have continued to make progress in implementing the transitional economic program. Key structural initiatives have been undertaken—such as freeing all reprogrammed deposits in the *corralón,* beginning the redemption of quasi-monies (Arg$1.5 billion equivalent already redeemed), and liberalizing foreign exchange controls—to provide a sound basis for the incoming government to embark on a sustainable medium-term program. In recent months, macroeconomic developments have been favorable continuing the trend that began in the latter half of 2002: economic growth has accelerated; the *peso* has strengthened, interest rates have fallen along with inflation, bank deposits have increased, and there has been a further build-up in international reserves. These positive developments were facilitated by a cautious monetary policy and continued fiscal consolidation. We are pleased to report that all end-March quantitative performance criteria were met with good margins.

2. As described in the attached Supplementary Memorandum of Economic Policies (SMEP) our strategy for the immediate future rests on the continuation of prudent fiscal and monetary policies and moving ahead with structural reform commitments under the program. While progress was made against several structural benchmarks, some structural measures have been subject to delay. We nevertheless remain committed to meeting the structural conditionality and will seek rapid progress in the period ahead. In view of our performance under the program up to March 2003, and the policies set out in the attached memorandum, the government requests waivers for the nonobservance of some structural performance criteria including the elimination of the competitiveness plans. There were also delays in the conversion of the fuel tax to an ad valorem basis, revisions to banking regulations, and the announcement of a minimum capital adequacy ratio, which have now been implemented.

3. In addition, we request a waiver for the nonobservance of the continuous performance criterion against the adoption of measures that provide for the involuntary suspension of creditor rights as a result of the legislation that was approved by congress on May 8 and became effective on June 2, 2003. This legislation prohibits for 90 days foreclosures on mortgages on primary residences; the stay, however, is of limited material impact and does not prevent the filing of new cases. The government will make every effort to ensure that no steps are taken that would result in a further suspension of the rights of creditors, and that the stay on mortgage foreclosures is terminated at the end of the 90-day period.

4. The ability of the government to lift the *corralón* and begin redemption of the federal and provincial quasi-monies is a measure of the macroeconomic and financial stability that has been achieved. We have been able to advance these policies, which we consider essential for rebuilding confidence, but they will involve the issuance of additional public debt. As they were not anticipated in the original program, we request a corresponding modification of the end-June performance criteria on the ceiling on the stock of federal government debt, the stock of debt of the consolidated public sector, and the cumulative primary balance of the federal government. The monetary program has been revised to take into account the favorable developments noted above that suggest a recovery in money demand, and remove the pressing earlier concerns that liquidity pressures on banks would undermine the monetary anchor. We propose that the end-June performance criteria on central bank NDA and NIR be modified accordingly. We anticipate that only end-May monetary performance criteria will be available by the time of the Board meeting, and accordingly request a waiver of the applicability of the end-May fiscal performance criteria for purposes of the purchase that will be made after the second review. As originally envisioned, observance of the end-May fiscal performance criteria will be a condition for the next purchase under the arrangement.

5. We will continue to maintain a continuous dialogue with the Fund on economic policies during the remaining period of the arrangement. The next review of the program, to be completed in July 2003, will be held in conjunction with financing assurances reviews, and will assess overall performance under the program and observance of the performance criteria, and compliance with the IMF's lending into arrears policy.

/s/
Dr. Roberto Lavagna
Minister of Economy

/s/
Lic. Alfonso Prat-Gay
President of the Central Bank

SUPPLEMENTARY MEMORANDUM OF ECONOMIC POLICIES OF THE GOVERNMENT OF ARGENTINA FOR A TRANSITIONAL PROGRAM

I. INTRODUCTION

1. This supplementary memorandum of economic policies (SMEP) describes recent economic developments, policies implemented since the last review, and plans for the remainder of the transitional program. 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, and the SMEP dated March 3, 2003.

II. ECONOMIC POLICIES FOR 2003

A. Macroeconomic Framework

2. Macroeconomic developments in the first months of 2003 have been better than anticipated, with a sharp recovery of output, an easing of inflationary pressures, and an appreciation of the *peso*. On the basis of this performance, the macroeconomic framework underlying the program has been revised. For 2003, real GDP growth is projected to be 4 percent, inflation is expected to average 15–20 percent, and the external current account surplus to reach US$7.7 billion. Gross international reserves are projected to increase by US$3.2 billion during 2003 to about US$13½ billion by end-2003.

B. Monetary Policy

3. While the targets for central bank NDA and NIR for end-March and end-May were met with significant margins, the growth of base money has been faster than projected, mainly reflecting unsterilized net purchases of foreign exchange. There are indications that this growth mainly reflects recovering money demand that can be accommodated without undue risk to financial stability while, at the same time, providing an important opportunity to rebuild international reserves. Accordingly, the NDA and NIR targets for the remainder of the arrangement are proposed to be modified and indicative targets for the monetary program to end-2003 have been established. The revised program targets base money growth for the remainder of the year broadly in line with nominal income, raising the end-June indicative target by about Arg$4 billion. The more rapid growth will reflect additional reserve accumulation.

C. Fiscal Policy

4. The cumulative consolidated primary surplus at end-March was Arg$400 million higher than programmed, reflecting a better than projected performance at both the federal and provincial levels. On the basis of fiscal performance so far, the remaining quantitative fiscal targets of the program are considered achievable without the need for additional measures.

5. At the federal level, buoyant tax revenues and tight control over spending more than offset lower than projected nontax revenues (mainly reflecting lower than expected central bank realized profits), although there were delays in refunds to exporters (which have since been reduced). Interest expenditures were also sharply lower because of delays in the issuance of bonds in connection with the banking crisis, and lower than budgeted interest rates. Every effort is being made to become current on refunds to exporters in the remaining period of the program. Disbursements from the MDBs continue to be significantly below programmed amounts, which has complicated expenditure management and increased reliance on temporary financing from the central bank. The government will continue to work with the MDBs to ensure that the shortfall is made up in the remaining months of the program.

6. While during January–March, public debt increased by Arg$2.2 billion less than programmed, it is expected that in the remaining months of the program there would be further public debt issuance reflecting: (i) compensation for exchange rate losses resulting from the *pesoization* that will be paid to depositors taking advantage of the scheme to liberalize the remaining deposit restrictions (the *corralón*); (ii) the redemption of federal and provincial quasi-monies; and (iii) compensation payments to banks for the impact of asymmetric indexation and *amparos*. As implementation of the schemes under (i) and (ii) was not envisaged at the time of the discussions for an SBA, it is now proposed that the debt ceilings of the program be adjusted accordingly.

7. The better than projected performance of the provincial governments reflected a strong recovery of their own tax revenues and continued tight control over spending. The targeted fiscal adjustment at the provincial level for 2003 is now anchored firmly by the *bilateral agreements*, which have been ratified by twelve provinces representing over 92 percent of the 2002 deficit, thereby meeting the structural benchmark in this key area.

8. Some delays have been encountered with respect to structural fiscal reforms. Congress approved the conversion of the fuel tax to an ad valorem basis on June 4, 2003 and a range of previously suspended competitiveness plans have been eliminated. However, three competitiveness plans (applying to media, freight, and public transportation) still remain. These remaining competitiveness plans will not be extended beyond July 31, 2003 (structural performance criterion), except for public transportation which will be terminated by end-December 2003. There have also been difficulties in timely reporting of provincial government finance data. Efforts have been made, however, to reduce the reporting lag for data on provincial finances, and the end-March data were submitted on time.

D. The Redemption of Quasi-Monies

9. By end-2003, all outstanding federal and provincial quasi-monies issued in 2001 and in the first half of 2002 (totaling about Arg$8 billion) are expected to be redeemed. Under the scheme, the federal government will borrow *pesos* from the central bank and will on-lend them to provinces; in redeeming federal quasi-money (*lecops*), the federal government will borrow the *pesos* on its own account. As most quasi-monies trade at close to par with the

peso, and all are included in the program definition of base money, the redemption should have no significant impact on the monetary program. The redemption is being supported by a World Bank loan of US$500 million. Thus far, the federal government and four provinces (which together account for over 50 percent of quasi-money issued) have redeemed the equivalent of Arg$1.5 billion of quasi-monies; three additional provinces are expected to begin redemption shortly.

E. Exchange controls

10. The exchange restrictions and controls introduced in 2001–02 have continued to be liberalized. In March, further increases were made in the ceilings on monthly purchases of foreign exchange for financial investments abroad, on the domestic use of foreign bank notes without prior authorization, and on debt arrears on which amortization is allowed. The time limits for export surrender and the period of prepaying imports were also extended.

11. Capital controls and exchange restrictions were liberalized further in mid-May, including: (i) a further extension of the time limit for export surrender and elimination of the need to surrender to the central bank, and easing of exports receipts subject to surrender requirement; (ii) elimination of the prior authorization requirement and an increase in the ceiling on debt arrears on which amortization is allowed; and (iii) the ceilings on monthly purchases of foreign exchange for financial investments abroad, and the domestic use of bank notes without prior authorization, were raised to US$500,000.

III. The Banking System

12. Since the first review of the program, further progress has been made in removing deposit restrictions, and in adapting the regulatory and prudential framework to reflect the current state of the banking system.

- The remaining restrictions on time deposits were eliminated by government decree on April 1, 2003. Depositors were offered a combination of cash, *peso*-denominated time deposits of 90 or 120 days (depending on deposit size), and a U.S. dollar-denominated bond in compensation for losses arising from the *pesoization* of their foreign currency time deposits. About 50 percent of deposits entered into the scheme by the time it expired on May 23, 2003; depositors who opted not to enter the scheme are to remain with their reprogrammed deposits.

- In April 2003, the central bank issued revised prudential norms for foreign exchange exposure and the valuation of government loans and bonds. Commercial loan classification and provisioning requirements, as well as guidelines for loan restructuring, were also revised to give temporary forbearance to help banks deal with the effects of the crisis. These rules were tightened on May 22 and we plan to phase out the temporary rules on loan restructuring earlier than scheduled.

- On May 29, 2003, the central bank approved a new minimum capital requirement scheme with a core ratio fixed at 8 percent of risk-weighted assets. Interest rate risk and market risk capital requirements were revised to reflect the new monetary, exchange and financial environment. After analyzing the information provided by the banks, the central bank will announce, by the third review, transitional paths for capital requirements related to exposure to the public sector and interest rate risk (a structural benchmark.

- The reporting by banks to the superintendency of financial statements and business plans/cash flow projections for 2003–04 was delayed by the revisions to the prudential regulations noted above. By end-October, 2003, banks will be required to submit financial statements for end-September 2003, business plans, and cash flow projections for 2004–05. These will be used by the central bank to assess banks' compliance with the revised minimum capital adequacy ratio.

- Draft legislation containing the mechanisms to regularize government payments to banks to compensate for the impact on their balance sheets of asymmetric indexation of their assets and liabilities and the court injunctions (*amparos*) has been submitted to congress.

- To partially offset interest rate and maturity mismatches for banks holding central bank rediscounts, the central bank issued implementing rules on April 29, 2003, for the restructuring of the existing stock of rediscounts to match more closely bank interest expenses and interest revenues resulting from exposure to the public sector; these rules will become effective in early June 2003.

- On May 21, 2003, we launched for Banco de la Nación the bidding process 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 the bank's operations. The bidding process for Banco de la Provincia de Buenos Aires, using the same terms of reference as for Banco de la Nación, is expected to be launched by the time of the Board meeting. A separate assessment is being made of the third largest public bank (Banco de la Ciudad de Buenos Aires), and a determination will be made of the appropriateness of its inclusion in the examination and review process by the third review of the arrangement.

- Legislation aimed at strengthening the institutional framework for bank resolution, and legal protection under civil law for officials involved in bank restructuring, was submitted to congress on May 23, 2003. We are working with legislators to incorporate into the legislation the need for the central bank's administrative budget to be subject to congressional scrutiny, and to obtain approval of the legislation by the third review.

IV. Legal Framework for Private Debt Restructuring

13. On May 8, 2003, congress approved legislation prohibiting for 90 days foreclosures on mortgages for primary residences, resulting in nonobservance of the continuous performance criterion prohibiting the involuntary suspension of creditor rights. While we did not sponsor the legislation, and recognize the need for a normalization of relations between banks and their customers, we believe that the material impact on financial sector balance sheets will be small given the relatively small share of bank lending involved and the lengthy foreclosure process. We will make every effort to ensure that there is no extension of this stay, and that no further involuntary suspension of creditor rights is introduced (a continuous structural performance criterion).

V. Safeguards Assessment

14. The central bank has made progress in implementing the recommendations of the Fund's safeguards assessment mission. Work is underway toward preparation of the 2003 financial statements of the central bank in accordance with the International Accounting Standards. A memorandum of understanding is also expected to be signed by the central bank and the government (by the third review) that determines the conditions under which realized central bank profits are transferred to the government.

VI. Medium-Term Framework

15. To prepare the ground for sustainable public finances, draft legislation is being prepared for a comprehensive reform of the tax system, and of intergovernmental relations (a structural benchmark under the program), which takes into account the recommendations of recent FAD technical assistance missions, aimed at securing the higher consolidated primary surpluses that will be needed over the medium term. The principal points to emerge from this process are contained in "white papers", which have been conveyed to Fund staff and to provincial governors for their comments ahead of preparation of the budget for 2004.

16. Sustainable public finances will also require agreement with private creditors on an appropriate restructuring of public debt. To this end, and in collaboration with our external debt advisors, we have begun to elaborate an action plan for negotiating with private creditors and for securing agreement on a restructuring that includes: advancing our dialogue with creditors through additional creditor meetings and the sharing of nonconfidential information on a timely basis; the upgrading of our investor relations website; and by responding to creditors comments and suggestions, and soliciting views from creditors on appropriate negotiation structures and restructured instruments. We also have made significant progress in building a database by type of creditor and magnitude of holdings, and we have strengthened our internal capacity to conduct a comprehensive debt sustainability analysis.

17. With respect to bilateral official creditors, relations are being normalized with Paris Club creditors, and the terms of reference for the reorganization of debt falling due through August 2003 is expected to be signed by the time of the Board meeting.

Revisions to the Technical Memorandum of Understanding

All elements of the Technical Memorandum of Understanding issued in connection with the first review of the arrangement remain in force, except for the revisions expressly mentioned below.

I. Revised Quantitative Targets

Quantitative Program Targets, May-June 2003

(In millions of pesos, unless otherwise indicated)

	End-May	End-June (revised)
A. Fiscal Targets		
1. Cumulative primary balance of the federal government (floor)	3,310	4,500
2. Cumulative overall cash balance of the federal government 1/	-2,708	-2,198
3. Federal government debt stock (ceiling)	603,000	612,000
4. Cumulative overall balance of the provincial governments 1/	...	-712
5. Consolidated public sector debt stock (ceiling)	640,000	650,000
B. Monetary Targets		
6. Stock of net international reserves of the central bank (in US$ millions) (floor)	-3,900	-2,250
7. Stock of adjusted monetary base 1/	37,200	40,400
8. Stock of net domestic assets of the central bank (ceiling)	52,215	49,063

1/ Indicative targets throughout the program period.

II. Other Revisions

1. The second paragraph under section 1 "Performance criterion on the cumulative primary balance of the federal government" is revised to read:

"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, in point (iv) of item 3 up to the amounts specified therein, and by the debt issued in connection with the lifting of the *corralón* for the amount calculated under adjustor f. in item 3 below."

2. Insert the following sentence at the end of the first paragraph under section 3 "Performance criterion on the stock of federal government debt:"

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

3. The second paragraph under section 3 "Performance criterion on the stock of federal government debt" is revised to include the following additional points:

   "f. Upward by the issuance of *Boden* 2013 to depositors in connection with the lifting of the *corralón*.

   g. Upward by the debt issued in connection with the redemption of provincial and federal quasi-monies."

Press Release No. 03/91
FOR IMMEDIATE RELEASE
June 20, 2003

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Second Review of Argentina's Stand-By Arrangement, Approves US$320 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the second review of Argentina's performance under a seven-month, SDR 2.17 billion (about US$3.1 billion) Stand-By Arrangement, which was approved on January 24, 2003 (see Press Release No. 03/09). The completion of this review enables the release of an additional SDR 226.2 million (about US$320 million).

The Executive Board also approved Argentina's request for waivers of the non-observance of certain performance criterion, and of the applicability of fiscal quantitative performance criterion for end-May 2003.

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

"Favorable macroeconomic developments and the easing of political uncertainties linked to the presidential elections have been key to strengthening market sentiment in Argentina in recent months. The economy is recovering and inflation has decelerated sharply, allowing domestic interest rates to fall, while the peso has strengthened. A large trade surplus has allowed an increase in international reserves. These signs of recovery are encouraging. But persistence in implementing structural reforms will be necessary to sustain the growth momentum. Therefore, in light of the progress that has been made so far, the Fund has approved completion of the second review under the Stand-By arrangement.

"The Fund looks forward to working closely with the authorities in developing a strong and confidence-building medium-term successor program that would sustain growth and reduce poverty. The forthcoming visit of the Managing Director will provide a good opportunity to exchange views with President Kirchner and his economic team on how to achieve these objectives," Mr. Köhler stated.

Statement by Guillermo Zoccali on Behalf of His Argentine Authorities
June 20, 2003

Overview

1. Recent economic, political and social **developments in Argentina have defied many earlier predictions of very bleak prospects** since mid 2002. As staff conclude in Annex I of EBS/03/82, recent developments point to a relatively robust recovery, with GDP expected to grow in 2003 by over 4.5 percent according to the latest revision. Moreover, recovering consumer confidence and market sentiment is being accompanied by faster than envisaged disinflation, a strengthening of the exchange rate, declining domestic interest rates, a lengthening maturity spectrum in open market operations, and rising bank deposits and international reserves.

2. These positive domestic developments exceeded the expectations associated with the transitional program and helped to lift some 1.8 million people out of poverty, according to a recent estimate. **These may be ascribed to prudent macro-economic policies and a high degree of ownership since mid 2002**, strengthened by the Fund-supported stand-by arrangement that will expire at the end of August. As importantly, Argentina's democratic institutions have withstood the test of the crisis and a smooth political transition concluded less than four weeks ago with President Kirchner taking office. The new administration and continuity in the economic team provide an excellent opportunity to clarify Argentina's outlook and overcome the daunting structural challenges that lie ahead, exemplified by a total public sector debt that is now projected at 132 percent of GDP by end-2003, compared to about 54 percent of GDP at end-2001.

3. **My authorities are encouraged by the Managing Director's upcoming visit to Argentina** and by the decision to strengthen the IMF's resident representative posting in Buenos Aires. They view these as important steps to help advance the adjustment and structural reform process to ensure the sustainability of the growth recovery during this critical juncture, which includes successive upcoming provincial elections in all but two provinces and the renewal of one-half of the House of Representatives and one-third of the Senate.

The Second Review of the SBA in Perspective

4. While acknowledging the contribution of cautious macro-economic policies and **over-compliance with all the end-March quantitative performance criteria under the arrangement,** staff focus on the accumulation of arrears to external private creditors as one of the reasons for the improving domestic situation. My authorities regret the accumulation of additional arrears to external private creditors on bonded sovereign debt and on official claims covered by Paris Club arrangements. However, the link should be also be made with their intense efforts to making the public finances sustainable, as evidenced by the significant turnaround in the primary surplus of both the federal and the provincial governments. In the interim, it is worth keeping in mind that all other debt obligations- domestic and external-

were kept current, and that net repayments to IFIs, amounted to some US$ 1 billion during January-May of this year. This follows a sharp decline in their Argentine exposure in the preceding year, which for the Fund alone was equivalent to some 28 percent of quota. If anything, my authorities are intent on making rapid progress in resolving the debt overhang problem, not least to dispel uncertainty regarding the medium-term outlook and given the negative bias this imparts on their attempts to continue strengthening confidence and restore credit, which is critical for a stronger export response and contribution to GDP growth.

5. The treatment given to the **structural conditionality** component in the staff report for this second review warrants specific commentary on the progress made and the materiality or macro-economic relevance of the requested waivers. While shortfalls in compliance with structural performance criteria or benchmarks under any arrangement are to be regretted in view of the unfavorable signaling connotations, my authorities view their significance in this case as overstated in the report. The waivers being requested are for the most part for actions already adopted or that have limited macro-economic impact. On the other hand, measures deemed critical by staff just a few months back, were also implemented, i.e. to address the monetary overhang from reprogrammed time deposits, redeem the quasi-monies in circulation and accelerate both the liberalization of foreign exchange restrictions and the ratification of the 2003 fiscal consolidation bilateral agreements with the provinces. Some of these **actions that had been considered almost too ambitious for inclusion in this transitional arrangement,** but **received only matter of fact or dispersed mention in this latest staff report**. On balance, it may be concluded, that the impact of the pre-electoral process on the structural reform effort was contained and that important headway was made on a number of macro-economically relevant issues that are helping to build-up confidence and medium-term sustainability.

6. More specifically on the **competitiveness plans**, the limited number of plans that have been extended until July 31 and December 31, 2003, should be seen in the context of the other twenty-seven sectoral plans that were eliminated along with the adoption of legislation that would have generalized these plans as of last April.

7. The significance of the unanimous decision of the Congress **suspending for 90 days foreclosures on loans secured by property that constitutes the sole family dwelling**, considered a breach of the continuous performance criterion under the arrangement, also diminishes when put in perspective. Box 3 of the staff report notes that the immediate direct impact of the law appears limited, as it affects only 0.6 percent of total credit to the private sector, and that it is unlikely to lead to a significant increase in strategic arrears by borrowers, as confirmed by the fact that nonperforming mortgage loans have actually decreased in recent months. Moreover, the law does not prevent lenders from initiating or continuing foreclosure proceedings. In any event, my authorities have committed themselves to avoiding further extensions to ensure that creditor rights are fully respected. These aspects contrast with the broad characterization in paragraph 22 pointing to the adverse effects of this legislation on business confidence, incentives to repay loans and the restoration of credit flows in the context of improving confidence. More generally, my authorities consider it an overstatement to suggest that the legislation will be reinforcing a culture of nonpayment as

the additional forbearance is mostly limited to single family mortgage borrowers in arrears, seriously affected by the unprecedented social and economic crisis unleashed by Argentina's disorderly exit from the currency board arrangement. In this light, the assertion in paragraph 27 of the report that "it appears that the link between legal certainty and new investment is still not widely understood" underscores rather the complexity of the post-crisis situation confronted by my authorities. At the same time, the economic recovery continues to impact positively on property values, thus providing an increasing incentive for mortgage borrowers to remain current despite the existence of such stays.

8. The comment in the report on the conversion of the **fuel excise tax to an ad valorem basis,** a structural performance criterion, as unlikely to have the expected positive revenue yield also points to the importance of correct prioritization of structural reforms in any arrangement. The legislative approval process focused attention and political capital on a well-intentioned measure. However, in practice this was less oriented at addressing distortions in the domestic fuel market and became less important in terms of revenue enhancement contribution after geopolitical considerations ceased to convalidate the peak in international oil prices.

9. The broader issue of enhancing tax revenue performance and eliminating distortionary taxation consistent with medium-term debt sustainability requirements brings out the importance of the **fight against tax evasion.** My authorities have announced this week a concerted campaign against evasion which includes the unification of the collection of taxes, customs tariffs and social security contributions, under the AFIP, the operation of the recently established tax tribunals to tighten enforcement and tougher penalties for all variants of tax evasion. In addition, they are intent on building consensus for tax reform which they have sought to advance with a "white paper" circulated for comments to Fund staff and provincial governors.

10. The pro-cyclical nature and inadequate incentives for fiscal consolidation by provincial governments have figured prominently among the causes of the Argentine crisis. My authorities are, therefore, particularly encouraged with the **provinces' fiscal performance in recent months,** which has also served to underpin the improvement in the primary balance of the consolidated public sector. The ratification by provincial legislatures of bilateral fiscal consolidation agreements with the federal government, representing the equivalent of over 92 percent of the aggregate 2002 provincial deficit and the shift to a higher than expected surplus this year points to the important progress being made in this critical area. The early **redemption of quasi-monies** already exceeds Arg$ 1.5 billion, equivalent to one-third of the stock issued by the provinces, in the first four weeks of the exchange. The fact that it is being effected at close to market value and has attracted wide voluntary provincial participation and without bail-out provisions, as noted in Annex II, adds to the significance of the turnaround in provincial fiscal management, which includes the timely provision of monthly government financing information with the end-March data. This performance suggests that the next stage of co-participation reform can also be credibly undertaken and should serve to balance the skepticism that otherwise could result from a "check-list" approach to assessing compliance with program conditionality.

11. On monetary policy, a conservative stance and prudent use of instruments of indirect monetary control have contributed not only to a steady strengthening of the demand for money but also to a marked disinflation, with the CPI actually decreasing in May, while containing pressures for excessive appreciation of the peso. This has required a moderate adjustment in the indicative ceiling on base money to allow for the replenishment of international reserves and over compliance with the performance criterion on NDA. The revision of the indicative money base target should not be interpreted, however, as an easing of the monetary stance since it is being accompanied by a substantially tighter NDA ceiling notwithstanding the strengthening demand for money and a higher floor for net international reserves locking in over compliance. In this context, it can be asserted that **monetary policy under the transitional arrangement remains cautious** and geared to fully establishing the credibility of the monetary authority consistent with the objective of introducing a full-fledged inflation-targeting framework. This transition will require increasing flexibility with respect to future indicative base money targets.

12. My authorities remain committed to securing early congressional approval of **amendments to the financial institutions law** to subject only the administrative budget of the central bank to congressional scrutiny as well as to give protection from civil lawsuits for officials engaged in bank restructuring responsibilities. Parenthetically, the reference in paragraph 1 of the report to the move by the new president to replace some (two) central bank directors is not factually complete. The designation process requires confirmation by the Senate, in these two specific cases the new government has withdrawn the respective nominations.

13. The **restructuring of the banking system** constitutes another major challenge facing the new administration and efforts to advance the restructuring agenda have recently accelerated, as noted by staff. Progress in this area included the voluntary scheme that anticipated the elimination of restrictions on reprogrammed time deposits, resulting in over 50 percent of the total entering the scheme, most of which remained in the banking system. Thus, the succession of voluntary schemes offered to depositors has resulted in only 12 percent of total bank deposits remaining voluntarily subject to the reprogrammed terms. The central bank also issued revised prudential norms for foreign exchange exposure and the valuation of government loans and bonds, as well as new guidelines for loan restructuring to help banks deal in the transition with the effects of the crisis. The initial concerns about excessive forbearance in the revised loan classification rules were addressed by the central bank in late May. Some degree of forbearance, on the other hand, has accompanied all post-crises bank resolutions strategies. New minimum capital requirements with a core ratio of 8 percent of risk-weighted assets were approved and transitional paths related to exposure to the public sector and interest rate risk are to be announced shortly based on updated balance sheet data from the banks.

14. My authorities are committed to rebuilding a bank regulatory and resolution framework that fosters soundness and credit for private sector growth. The launching of the bidding process for due diligence examinations on the two largest official commercial banks, with the concurrence of the shareholders, constitutes another important step in this regard. At

this juncture when confidence in the banking system is steadily improving, my authorities deem it important that the phasing-in of more stringent loan classification and provisioning rules, including mark-to-market of claims on the government, be carefully calibrated to the normalization of economic conditions. They have used the increasing degree of social stability and depositor confidence to strengthen bank balance sheets, within the limits of their legal authority, with prudential measures and guidelines to foster solvency and to compensate banks for the impact of asymmetric pesoification. Congressional action is expected to allow for the compensation to banks for the balance sheet impact of asymmetric indexation of assets and liabilities and the costs of meeting earlier court injunctions or "amparos". In sum, **my authorities are in basic agreement with staff on the objectives of the bank restructuring strategy adapted to the new monetary, exchange and financial environment.** In this regard, it is pertinent to keep in mind that the timing governing implementation of decisions requiring congressional approval lies largely outside the authorities' control. Best efforts are nonetheless being made to ensure that these measures remain consistent with the objective of strengthening banking system soundness, profitability and efficient financial intermediation.

15. Work is also proceeding on the issue of **adjustment of utility rates** that have remained frozen, except for seasonal hikes that were not rolled back, since the devaluation in January 2002. Repeated attempts to introduce adjustments through presidential decrees were challenged in Courts. In the interim, the combination of economic recovery, disinflation, declining interest rates and strengthening of the exchange rate has allowed for a substantial improvement in the cash-flow performance of the privatized service utilities, and one of them has already restructured its external liabilities with private creditors. In any event, the government is discussing with Congress the delegation of authority to set new rates keeping in mind the need to maintain the quality of services.

16. The **negotiation to restructure the sovereign debt in arrears** is uppermost in my authorities' agenda of the issues bearing on Argentina's medium-term sustainability and the full restoration of confidence. Work has proceeded with Argentina's international advisor to build up the private database of sovereign bonded debt holders, the in-house capacity for debt sustainability analysis and, most importantly, the dialogue, including formation of creditor groups, and the sharing of possible restructuring options and other non-confidential information that would enable the initiation of negotiations expeditiously in the context of agreement on a medium-term policy framework under a successor arrangement that could be supported by the international community. The Secretary of Finance is currently in Europe with the primary purpose of meeting bondholders and laying the basis for the upcoming negotiations. To this end, and in keeping with my authorities' policy of full transparency regarding the policy commitments undertaken with the international financial community, they have disseminated the LOI, MEP and TMU pertaining to the current stand-by arrangement with Fund. They have also agreed to the publication of the staff report pursuant to this second review with appropriate corrections and deletions, as well as to the inclusion in the Fund website of previous 2002 Article IV and 2003 UFR staff reports, together with the statements issued reflecting their point of view.

Conclusions

17. Against this backdrop, my authorities look forward to a continued close dialogue with the Fund that takes advantage of the hard-won but favorable momentum in post-crisis economic, social and institutional normalization. In particular, economic policy has been successful in advancing from stabilization to a second phase of recovery for growth. **My authorities consider that the conditions are favorable for the third stage of structural reforms, to complete the medium-term policy framework that will deliver sustainable public finances and strong equitable growth in Argentina**. The Executive Board's support for the conclusion of the second review under the Stand-by Arrangement constitutes an essential stepping-stone towards this goal.