INTERNATIONAL MONETARY FUND

IMF Country Report No. 17/409

ARGENTINA

December 2017

2017 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR ARGENTINA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2017 Article IV consultation with Argentina, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its December 18, 2017 consideration of the staff report that concluded the Article IV consultation with Argentina.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on December 18, 2017, following discussions that ended on November 10, 2017, 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 December 1, 2017.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staff of the IMF.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for Argentina.

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

Selected Issues

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

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December 29, 2017

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IMF Executive Board Concludes 2017 Article IV Consultation with Argentina

On December 18, 2017, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Argentina.

Argentina's government has unwound multiple distortions and made important progress in restoring integrity and transparency in public sector operations. These policy changes have put the economy on a stronger footing and corrected many of the most urgent macroeconomic imbalances. Argentina is experiencing a solid recovery from last year's recession and, even in the face of planned fiscal consolidation and ongoing efforts at disinflation, growth is expected to consolidate in the coming years. Inflation continues to fall, albeit at a slower pace than targeted by the central bank.

Private consumption strengthened in 2017, supported by greater real wages and buoyant credit growth, and private investment is also picking up. With stronger domestic demand, the trade surplus turned into a deficit and the current account deficit increased. Annual inflation has declined from its peak in 2016, but remained relatively resilient and inflation expectations moved up, prompting the central bank to raise interest rates. The general government fiscal deficit is expected to increase this year, despite the fall of the primary deficit, and its financing led to a rapid rise in foreign currency borrowing. The slower-than-targeted decline in inflation and significant foreign inflows have put upward pressure on the exchange rate, which in real terms has appreciated by about 3 percent so far in 2017.

Going forward, GDP growth is expected to consolidate, inflation inertia will slowly subside, and the fiscal deficit will gradually fall. Private consumption is expected to strengthen in 2018–19 as real wages recover from the decline in 2016. The federal primary fiscal deficit is expected to fall by 2 percent of GDP by 2019, while provinces are projected to lower their primary deficit, in line with the targets announced by the authorities. This is likely to weigh against economic growth in the next two years, holding it to around 2½ percent. Continued sizable foreign borrowing and real appreciation pressures of the currency are expected to cause the current account deficit to

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

increase further. As wage negotiations continue to become more forward-looking, inflation expectations should move lower, creating space for an eventual reduction in policy rates. While still high real interest rates will act as headwind to growth, they should facilitate a decline in inflation towards single-digit levels.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They welcomed the continuing recovery of Argentina's economy from the recession that began in 2015. They commended the authorities for putting in place measures that facilitated the economic rebound, and for the progress made in the systemic transformation of the Argentine economy, including efforts to rebuild institutions and restore integrity, transparency, and efficiency in government. At the same time, they noted that important challenges remain and further efforts are needed.

Directors agreed that a lower fiscal deficit would reduce external vulnerabilities, build credibility, and help anchor inflation expectations. Many Directors supported a more frontloaded fiscal rebalancing, which would allow for lower interest rates, reduce upward pressures on the peso, and limit vulnerabilities to a sudden tightening of external financing conditions. A number of other Directors, while concurring with the need to reduce the fiscal deficit, also noted the potential economic growth and social impact of faster consolidation. They welcomed, in this context, the authorities' openness to considering accelerating the pace of fiscal adjustment if upside risks materialized. Directors noted that lowering government spending is essential, especially in areas where expenditure has increased very rapidly over the past several years, notably wages, pensions, and social transfers. They stressed, however, the importance of mitigating the impact of the fiscal rebalancing on the most vulnerable segments of the population.

Directors also encouraged the authorities to continue strengthening the institutional framework for fiscal policy, and welcomed the recent agreement between federal and provincial governments, which should encourage fiscal discipline. They recommended considering the adoption of a medium-term fiscal anchor and a stronger enforcement mechanism.

Directors welcomed the proposed tax reform, which is a good step forward to overhaul the inefficient tax system. The proposal supports investment, increases the progressivity of the system, and reduces the disincentive to formal employment. Directors noted that more could be

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

done to eliminate distortionary taxes, and cautioned against relying on uncertain growth effects to offset revenue losses from the tax reform.

Directors welcomed the authorities' commitment to maintaining a tight monetary policy stance in order to achieve their inflation targets. They stressed that reducing monetary financing of the deficit would help strengthen central bank independence and enhance the credibility of the inflation-targeting regime.

Directors emphasized the need for an ambitious supply-side reform agenda. They commended the authorities for removing foreign exchange controls and trade restrictions, and for recent initiatives to reduce red tape. They noted that boosting productivity and long-term growth would require a more accelerated reduction in import tariffs, elimination of most import licenses, removal of barriers to investment and firm entry, and measures to boost domestic competition. Maintaining efforts to fight corruption will also be critical. Directors emphasized the need to continue to develop the financial system and increase financial inclusion, while strengthening oversight and protecting financial stability.

Directors called for measures to reduce informality, address gender discrimination, and ensure that the benefits from higher growth are shared more equally. The proposed tax reform should increase opportunities for formal employment for the less-educated and young people.

It is expected that the next Article IV consultation with Argentina will be held on the standard 12-month cycle.

Argentina: Selected Economic and Financial Indicators

	Average			Proj.					
	2009–14	2015	2016	2017	2018	2019	2020	2021	2022
	(Annual percentage changes unless otherwise indicated)								
National income, prices, and labor markets									
GDP at constant prices	1.5	2.6	-2.2	2.8	2.5	2.8	3.1	3.1	3.2
Domestic demand	2.6	4.0	-1.5	5.4	3.7	3.2	3.4	3.3	3.4
Consumption	2.8	4.0	-1.2	4.5	2.6	2.7	2.8	2.8	3.2
Private	2.6	3.5	-1.4	5.1	3.3	3.4	3.4	3.4	3.6
Public	4.5	6.8	0.3	1.3	-1.3	-1.5	-0.7	-0.8	0.6
Investment	1.6	3.8	-5.1	13.1	9.3	5.0	5.4	5.2	4.1
Private	1.0	4.4	-6.3	16.4	14.3	6.1	5.2	4.9	4.2
Public	5.0	3.9	-1.2	2.2	-9.1	-0.1	6.5	6.8	3.7
Exports	-1.0	-0.6	3.7	1.7	8.0	6.2	5.7	5.3	5.0
Imports	4.4	5.7	5.7	12.3	10.7	6.4	5.9	5.4	4.8
Change in inventories and stat. disc. (contribution to growth)	0.1	0.0	0.5	-0.6	-0.2	0.0	0.0	0.0	0.0
Nominal GDP (billions of Argentine pesos)	2,609	5,854	8,050	10,326	12,735	14,877	16,986	19,199	21,617
Output gap (percent)	...	1.2	-2.1	-1.5	-1.6	-1.4	-1.2	-1.0	-0.7
CPI inflation (eop, y/y percent change)	...	...	...	23.6	16.3	11.8	10.0	9.3	8.6
Unemployment rate (percent)	7.5	...	8.5	8.1	7.7	7.2	6.8	6.4	6.1
	(Percent of GDP unless otherwise indicated)								
External sector									
Exports f.o.b. (goods, billions of U.S. dollars)	71.9	56.8	57.8	58.5	63.5	67.8	71.9	76.2	80.2
Imports f.o.b. (goods, billions of U.S. dollars)	60.1	57.2	53.2	63.3	68.8	74.2	79.5	84.9	89.1
Trade balance (goods, billions of U.S. dollars)	11.8	-0.4	4.5	-4.8	-5.3	-6.4	-7.6	-8.6	-8.9
Trade balance (goods)	2.6	-0.1	0.8	-0.8	-0.8	-0.9	-1.0	-1.0	-1.0
Terms of trade (percent change)	1.6	-4.0	6.1	-4.7	-1.0	-0.6	-0.7	-0.8	-0.3
Total external debt	34.7	28.3	36.1	36.2	38.8	39.9	42.4	45.1	47.8
Savings-Investment balance									
Gross domestic investment	16.3	15.8	14.8	16.3	17.3	17.5	17.8	18.1	18.2
Gross national savings	15.7	13.1	12.2	12.0	12.9	13.1	13.3	13.5	13.5
Current account balance	-0.5	-2.7	-2.7	-4.3	-4.4	-4.4	-4.5	-4.6	-4.7
Public sector 1/									
Primary balance	-1.9	-4.7	-4.8	-4.7	-3.7	-2.5	-1.9	-1.9	-1.7
of which: Federal government	-3.4	-4.1	-4.3	-4.2	-3.2	-2.2	-2.0	-1.9	-1.8
memo: Structural federal primary balance 2/	-1.4	-4.7	-4.5	-4.3	-2.8	-1.9	-1.8	-1.7	-1.7
Overall balance	-2.9	-5.9	-6.5	-6.9	-6.0	-5.0	-4.5	-4.9	-5.2
of which: Federal government	-2.4	-5.2	-5.9	-6.3	-5.5	-4.7	-4.5	-4.9	-5.3
Revenues	31.6	35.7	35.7	34.8	34.0	34.0	34.0	33.7	33.7
Primary expenditure 3/	34.9	40.5	40.4	39.5	37.7	36.5	35.9	35.6	35.5
Total public debt (federal)	42.9	56.0	54.2	52.8	51.7	50.6	50.5	51.4	52.7

Money and credit									
Monetary base (eop, y/y percent change)	27.5	34.9	31.7	21.2	17.4	14.6	13.4	12.6	12.0
M2 (percent change)	28.7	28.2	30.4	22.6	19.0	15.3	14.1	12.9	12.0
Credit to the private sector (eop, y/y percent change)	28.9	35.7	31.2	39.4	22.8	17.4	15.4	14.4	13.2
Credit to the private sector real (eop, y/y percent change)	…	…	…	12.8	5.6	5.0	4.9	4.7	4.2
Interest rate (eop) 4/	16.3	32.2	23.9	27.8	20.3	16.2	14.7	14.1	14.2
Real interest rate (eop) 4/	…	…	…	9.9	7.6	5.6	4.9	5.0	5.1
Memorandum items									
Gross international reserves (billions of U.S. dollars)	42.0	25.6	39.3	50.7	56.2	57.5	60.9	65.2	69.3
Exchange rate (eop, Arg$/US$)	5.3	13.0	15.9	…	…	…	…	…	…
Change in REER (eop, y/y percent change)	8.4	5.3	-3.4	3.2	2.8	2.2	1.3	0.8	0.5

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

1/ The primary balance excludes profit transfers from the central bank of Argentina. Interest expenditure is net of property income from the social security fund before 2016.

2/ Percent of potential GDP.

3/ Includes transfers to municipalities, but excludes municipal spending.

4/ Average of all LEBAC maturities before 2017 and midpoint of the repo corridor starting in 2017; ex ante real rates.

INTERNATIONAL MONETARY FUND

ARGENTINA

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION

December 1, 2017

KEY MESSAGES

The economy is rebounding. The government has unwound multiple distortions and made important progress in restoring integrity and transparency in public sector operations. These policy changes have put the economy on a stronger footing and corrected many of the most urgent macroeconomic imbalances. Argentina is experiencing a solid recovery from last year's recession and, even in the face of planned fiscal consolidation and ongoing efforts at disinflation, growth is expected to slowly pick up in the coming years. Inflation continues to fall, albeit at a slower pace than targeted by the central bank.

But tensions have emerged. Despite these positive developments, imbalances in the policy mix are generating important negative side effects. The large fiscal deficit has led to a surge in foreign currency borrowing, a growing current account deficit, significant gross external financing needs, and upward pressure on the real exchange rate. At the same time, continued monetary financing of the fiscal deficit has weakened the credibility of the central bank's inflation targeting framework.

A better policy mix is needed. The federal authorities plan a 2 percent of GDP reduction in the primary fiscal deficit in 2018–19. A more assertive reduction in the fiscal deficit would ease some of the emerging strains. This will require a front-loaded effort to reduce spending on wages, pensions, and discretionary transfers to provinces. Doing so will both lower the fiscal deficit and create space to reduce distortionary taxes. These measures should, however, be combined with steps to mitigate the impact on the poor, including through targeted cash transfers, protecting the real value of the basic pension and of social transfers, and reducing payroll taxes for lower income workers. To be clear, what is needed is a recalibration of the policy *mix*—a faster reduction in the fiscal deficit, lower taxes, and a less restrictive monetary policy—*not* an overall tightening of policies. This would allow for lower interest rates, better-anchored inflation expectations, less upward pressure on the peso, a more sustainable path for the public debt, and reduced vulnerability to a tightening of external financing conditions.

Structural reforms will be indispensable. Making progress on supply-side reforms will support growth, raise productivity, incentivize private investment, and erode some of the currency overvaluation. Reforms will need to make sure that the benefits from stronger growth extend to all parts of society, lowering poverty, improving job quality, and reducing informality, particularly for the young and for women. Priorities include a less distortionary tax system, a more balanced system of labor market regulations, greater competition in domestic product markets, confronting corruption, and eliminating barriers to trade and foreign investment.

Approved By
Nigel Chalk (WHD) and Daria Zakharova (SPR)

The staff team comprising R. Cardarelli (head), L. Lusinyan, J. Canales-Kriljenko (all WHD), P. Dudine (FAD), A. Pienkowski (SPR), and F. Figueroa (LEG) visited Buenos Aires during October 30–November 10, 2017. J. A. Sarmiento Monroy (WHD) provided research assistance. Mr. Werner (WHD) joined the concluding meetings. Mr. Lopetegui (OED) participated in the meetings. The mission met with senior officials and representatives of the private sector, finance industry, academics, and think-tanks.

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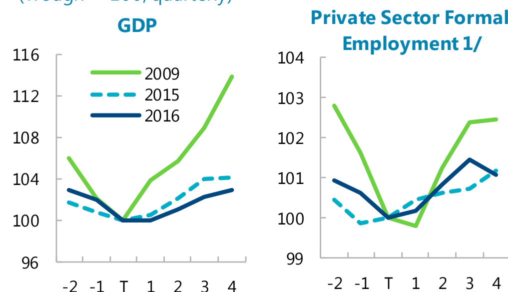
THE PITFALLS OF FISCAL GRADUALISM

1. **Argentina has been engaged in a systemic transformation of its economy**. The removal of foreign exchange controls, modernization of monetary policy, resolution of the dispute with bond holders and return to international capital markets, and the realignment of utility tariffs have corrected the most urgent macroeconomic imbalances. Institutions have been rebuilt and strengthened, and notable progress made in restoring integrity, transparency, and efficiency at all levels of government. These efforts have yielded significant budgetary savings and laid the foundation for stronger private sector investment in the years to come.

2. **These, and other policy changes, have resulted in a steady recovery from the recession that began in mid-2015**. Initially driven by a growth in public investment) and exports, the recovery is consolidating with GDP growing at an annualized pace of 2¾ percent in Q2, driven by an acceleration in private consumption and investment (Figure 1). Still, the pace of the recovery has been relatively slow compared to recent cycles, and output remains below potential. Following a contraction in early 2016, job creation has accelerated, with about 225 thousand jobs created in the twelve months to August. About 60 percent of them, however, are low income, self-employed jobs. Labor force participation has recovered somewhat, keeping unemployment at around 9 percent, but female labor force participation is low and labor market informality is stable at about 30 percent. Poverty has fallen somewhat, but remains high at around 28 percent.

Last 3 Recession Cycles
(Trough = 100, quarterly)

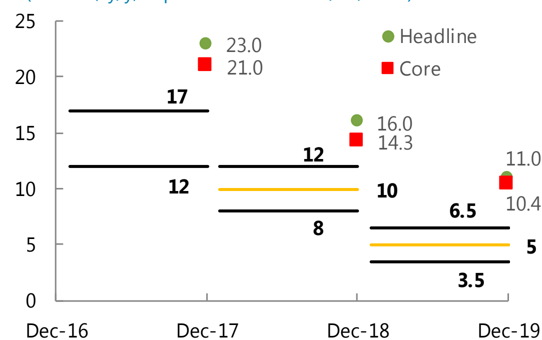


Sources: INDEC, Ministry of Labor, Haver Analytics, and Fund staff calculations.
1/ Salaried employment for 2009.

3. **However, tensions are emerging**.

- ***Inflation has fallen but remains stubbornly high***. After peaking at 47 percent in July last year, annual inflation slowed to 23 percent by October 2017, as the impact of the large exchange rate depreciation and tariff adjustments in 2016 dissipated (Figure 2). Despite a negative output gap, headline inflation hovered close to 1.8 percent per month since the end of last year, above the central bank's targeted path. This has partly reflected an ongoing increase in utility tariffs (to unwind the significant subsidies built up over many years) as well as high inflation expectations (which have crept up since May). The central bank (BCRA) has responded by raising the ex-ante real policy interest rate to around 11 percent as of November.

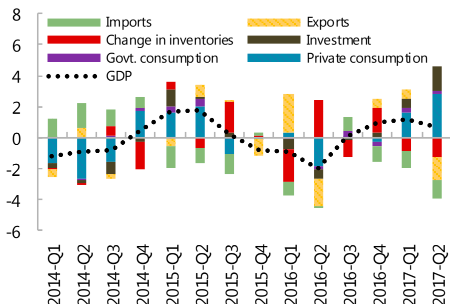
Inflation Targets and Expectations
(Percent, y/y; expectations as of 10/31/2017)



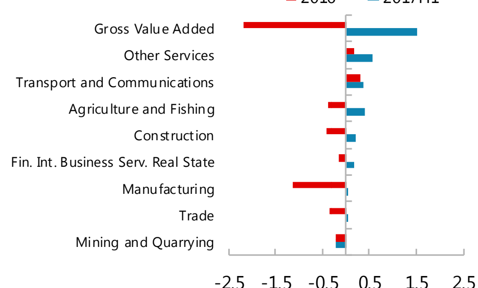
Source: BCRA.

Figure 1. Argentina: An Economy in Recovery

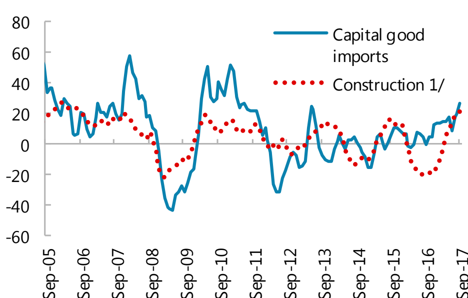
GDP growth increased 1 percent on average (q/q) in 2017H1, driven by private consumption and investment.



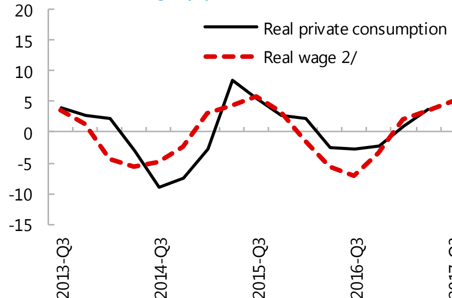
Agriculture, construction, transport, and other service sectors were the main drivers of growth.



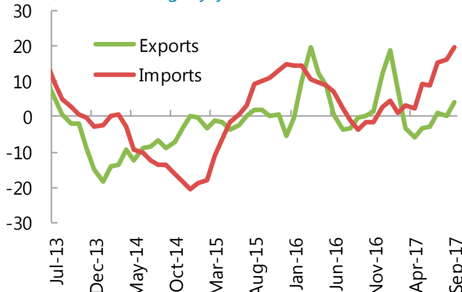
The pick-up in construction and imports of capital goods point to buoyant investment.



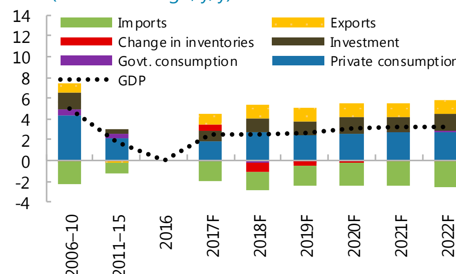
The increase in real wages is boosting private consumption.



Imports of goods have accelerated strongly, much faster than exports.



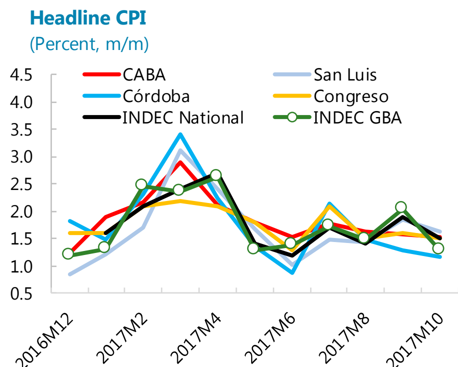
Going forward, we expect growth to gradually pick to 3 percent in the medium term.



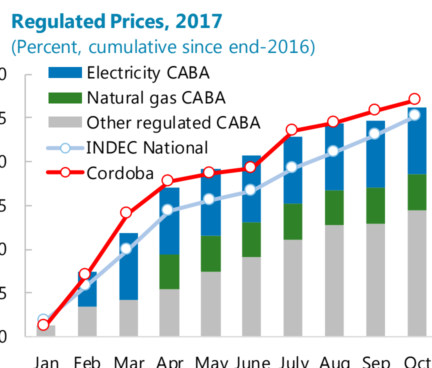
Sources: Instituto Nacional de Estadística y Censos (INDEC), Banco Central de la República Argentina (BCRA), Ministerio del Trabajo, and Fund staff calculations.
1/ Construction Activity Index (Grupo Construya).
2/ Data for 2017Q3 are computed as a three-month moving average through August.

Figure 2. Argentina: Inflation Remains Stubbornly High

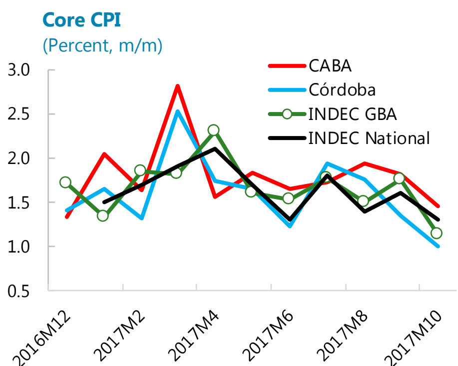
Monthly headline inflation has hovered around 1.8 percent since late last year.



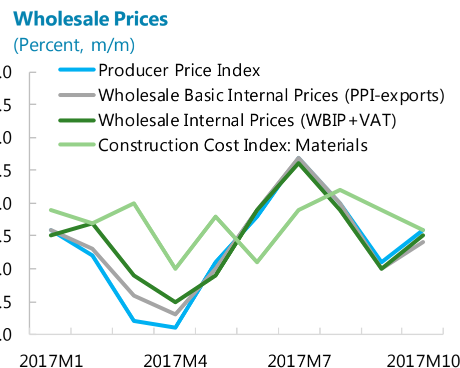
Regulated prices (utilities and other) contributed about 6 percentage points to headline inflation in 2017.



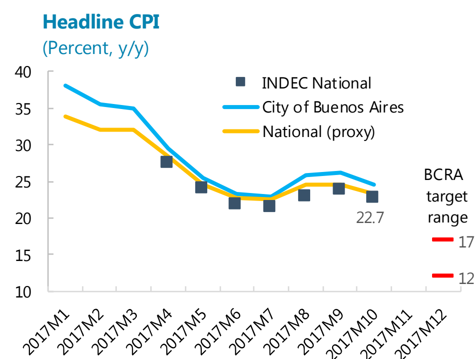
Core inflation has shown a broadly similar pattern to headline.



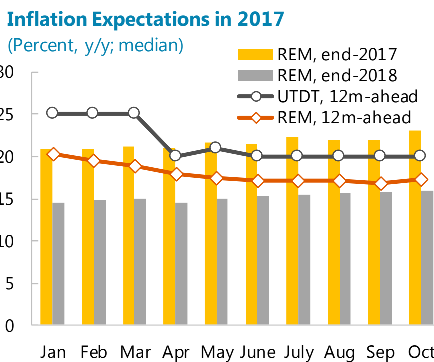
Wholesale prices moderated since mid-2017, but their growth also changed a little since last year.



The new national CPI from INDEC has moved broadly in line with the index for the City of Buenos Aires.



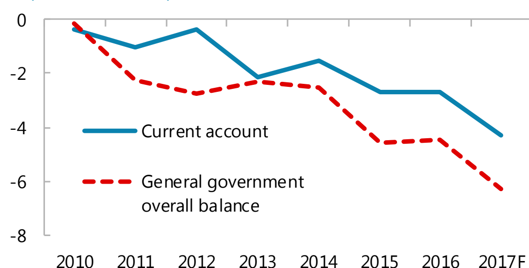
Inflation expectations remained very sticky, well above the central bank targets.



Sources: Instituto Nacional de Estadística y Censos (INDEC), Banco Central de la República Argentina (BCRA), provincial statistical offices, private analysts, Haver Analytics, and Fund staff calculations.

- ***The current account deficit has grown***. Import growth accelerated in 2017, fueled by the exit from recession and a strong peso. A growing trade deficit and a steady decline in the service and income balances have increased the current account deficit to 3½ percent of GDP (on a 12-month basis) in Q2. This higher current account deficit has been financed mostly by debt inflows as both public and private sectors have re-leveraged.

Current Account and Overall Fiscal Balances
(Percent of GDP)



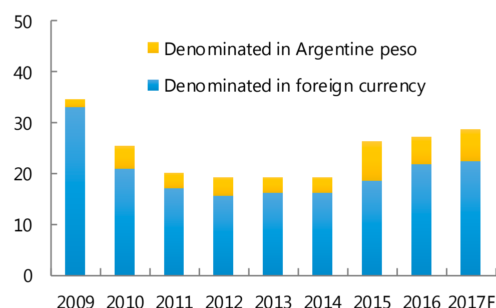
Sources: BCRA, INDEC, Ministerio de Hacienda, and Fund staff calculations and estimates.

4. These developments are the direct side-effects of imbalances in the policy mix. The primary federal fiscal deficit has remained broadly unchanged in 2017. However, adjusting for the tax amnesty and the economic cycle, the structural primary federal deficit fell by ¼ percent of potential GDP in 2017 (Figure 3). At the provincial level, the primary deficit has been broadly constant this year. The fiscal deficit has been financed partly by foreign and domestic borrowing (largely through U.S. dollar or dollar-linked instruments), and partly by the central bank (albeit at a lesser level than under the previous administration). Higher interest payments have led the overall general government deficit to increase from 6 percent of GDP in 2015 to 7 percent of GDP in 2017. The high deficit and sizeable gross financing needs mean Argentina's fiscal space is limited.

5. The gradualist fiscal strategy adopted by the authorities smoothed the impact of the needed consolidation on activity and jobs but comes with negative side effects, including:

- ***Public debt***. There has been a significant increase in public debt, and a high level of dollarization in both federal and provincial government liabilities. Domestic financing of the public sector has grown at a brisk pace, which may have crowded out private investment (although credit to the private sector has also accelerated over the past few months). Finally, the rapid pace of external borrowing has created a large external financing need in the coming years.

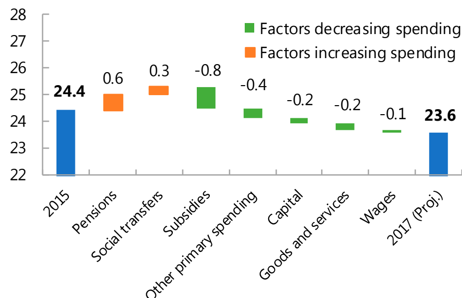
Stock of Federal Debt Toward the Private Sector
(Percent of GDP)



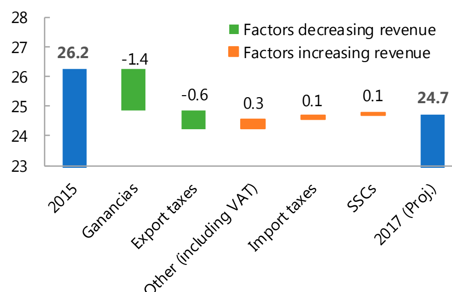
Sources: Ministerio de Hacienda and Fund staff calculations.

Figure 3. Argentina: Addressing Fiscal Imbalances

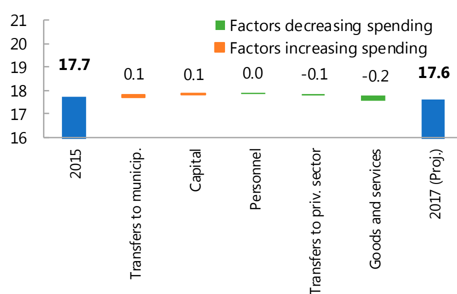
Over the last two years, federal primary spending has fallen.



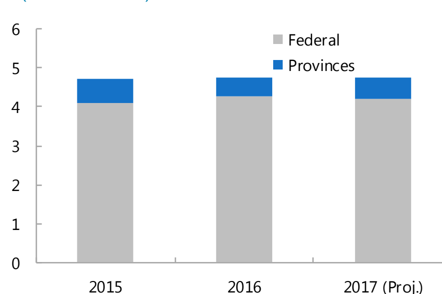
Together with extra revenues from the tax amnesty, this funded a cut in personal income and export taxes.



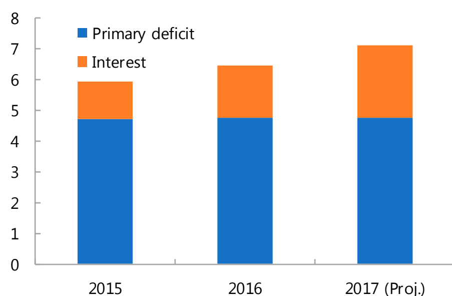
Spending at provincial level has remained broadly unchanged.



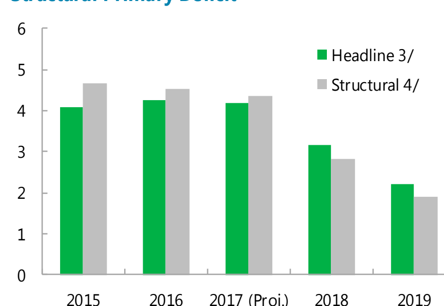
The general government primary deficit has remained high…



…and, with greater interest spending, the overall deficit has increased.



Adjusting for one-offs and the economic cycle, the federal primary deficit fell slightly in 2016-17.

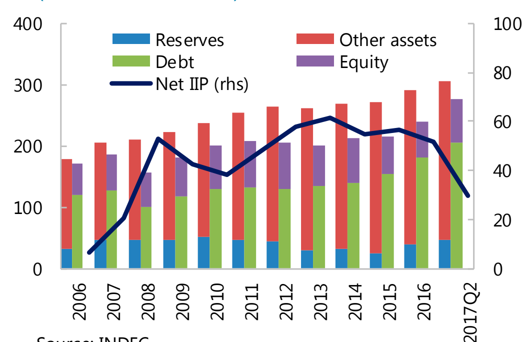


Sources: Ministerio de Hacienda, and Fund staff calculations.
1/ Includes discretionary transfers to provinces, and excludes floating.
2/ Excludes revenues from the tax amnesty in 2016 and 2017.
3/ Percent of GDP.
4/ Percent of potential GDP.

- ***Inflation***. The high fiscal deficit continues to be partly financed by the central bank (through advances and profit transfers amounting to 1½ percent of GDP in 2017), which has complicated the central bank's task in bringing down inflation. The monetary impact of fiscal financing and reserve purchases has been sterilized, which has resulted in a large increase of the stock of short-term BCRA liabilities (currently at about 125 percent of the monetary base). In addition to risks of large quasi-fiscal costs, the perceived risk that this large stock could be inflated away in the future may have undermined the credibility of the disinflation effort.

- ***External imbalances***. The increase in foreign financing (mainly from public borrowing and, to a lesser extent, a re-leveraging of the corporate sector) and low global risk premia have resulted in upward pressure on the real exchange rate. As a result, staff judge the currency to be 10 to 25 percent overvalued. This has left the external position in 2017 moderately weaker than the level consistent with medium-term fundamentals and desirable policies (see Annex I). Further, these same forces have acted as a headwind to both FDI and domestically-funded private investment, and have worsened the net international investment position (increases in private and public debt liabilities have been only partially offset by higher central bank reserves).

Net International Investment Position
(Billions of U.S. dollars)



Source: INDEC.

Exchange Rate Assessment Tools

	Level 2017	'Norms'	REER Gap (Percent)
EBA - exchange rate, Index	105.6	95.2	10.4
EBA - current account, % GDP	-4.3	-2.6	26.2
ES approach - current account, % GDP	-4.3	-2.9	23.5

Source: Fund staff estimates.

Note: Based on a elasticity of current account to REER of -0.06.

OUTLOOK AND RISKS

6. **Over the near-term, GDP growth is expected to accelerate, inflation inertia will slowly subside, and the fiscal deficit will gradually fall**. Private consumption is expected to strengthen in 2018–19 as real wages recover from the decline in 2016. The federal primary fiscal deficit is expected to fall by 2 percent of GDP by 2019 and remain relatively stable thereafter, which will stabilize the federal debt at a little above 50 percent of GDP (see Public Debt Sustainability Analysis). Provinces are projected to lower their primary deficit, as they become constrained by the spending caps in the new Fiscal Responsibility Law (sent to Congress in October). This consolidation will weigh against growth in the next two years, holding it to around

2½ percent. Despite this fiscal adjustment, the imbalance in the policy mix, sizable foreign borrowing, and a continued real appreciation of the currency are likely to cause the current account deficit to deteriorate further, exceeding 4½ percent of GDP by 2022 (Annex I). As wage negotiations continue to become more forward-looking, inflation expectations should move lower, creating space for an eventual reduction in policy rates (of around 700 basis points by end-2018). High real interest rates will act as a headwind to growth but should facilitate a decline in inflation to 16½ percent by end-2018 and to single digits by 2021.

7. There are important external and domestic downside risks facing Argentina (see RAM).

- ***External financing***. Despite lower primary fiscal deficits, the relatively small domestic financial system means that the external financing needs of the federal government will remain high well into the medium-term (Annex II). As such, any tightening in external global financial conditions could prove disruptive. In the worst case, external financing constraints could force a stronger fiscal consolidation and lead to lower private investment, triggering a renewed recession.

- ***Currency overvaluation***. Continued strength in the real exchange rate could be an obstacle to a pick-up of investment, depressing growth and job creation. A more problematic risk would be if markets perceive the currency as being significantly out of line with medium-term fundamentals. This could trigger a sudden, sharp adjustment of the nominal exchange rate that would complicate efforts at disinflation and, given the dollarization of public liabilities, lead to a step increase in the public debt-to-GDP ratio.

- ***Inflation inertia***. Greater-than-expected inertia in both inflation and inflation expectations could necessitate a tighter monetary policy stance (i.e. higher real interest rates and a more appreciated peso) to bring inflation down to single digits. This would eat into future growth prospects.

- ***Upside risks***. Growth could rebound at a faster pace than projected if the strengthened mandate of the governing coalition (after the October 2017 mid-term elections) facilitates an acceleration of structural reforms.

8. ***Authorities' view***. The authorities had a more optimistic view on the GDP growth outlook. They stressed that most recent data point to a very strong third quarter, and that both private consumption and investment will continue at a strong pace in the future. On investment, they pointed to the extremely good prospects in construction (as the mortgage boom will stimulate an upgrade of the stock of housing supply) and in energy and transportation sectors (where PPP projects are expected to begin soon). Spending on public works is expected to flatten out, but its impact on growth will be much higher than in the past, thanks to improved governance and greater efficiency. Finally, the tax reform and labor and product market reforms are expected to generate a productivity shock that will boost potential growth. The authorities did not regard the exchange rate to be overvalued, and saw the exchange rate and external

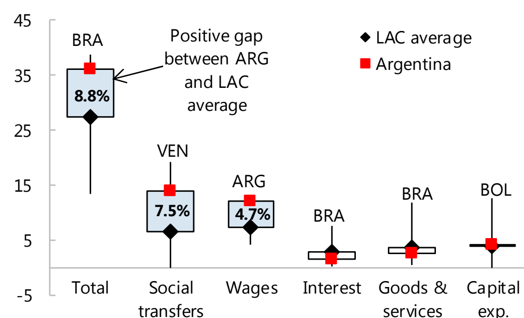
position as being consistent with Argentina's improving fundamentals. They saw near-term prospects for inflation likely to be influenced by upcoming increases in tariffs. However, favorable base effects, together with tight monetary policy and moderate wage increases will contribute to lower inflation by end-2018.

A SMALLER PUBLIC SECTOR AND A BETTER POLICY MIX

A. Fiscal Policies

9. General government spending is projected to remain high despite the planned fiscal adjustment by the federal and provincial governments. The expected reduction in the federal spending over the next two years would imply a decline in federal primary deficit of around 2 percent of GDP. The bulk of these savings come from lower energy and transportation subsidies. Even so, general government primary spending will still be high by regional standards and heavily concentrated in wages, pensions and social transfers. Such a high level of spending is fundamentally unsustainable, precludes a reduction of Argentina's high and distortionary tax burden, and acts as an important impediment to investment, competitiveness, job creation, and growth.

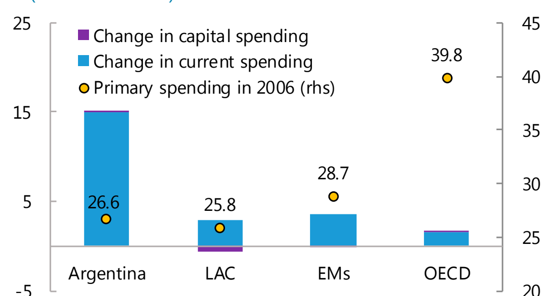
General Government Expenditure, 2019
(Percent of GDP)



Source: Fund staff estimates.

10. A frontloaded reduction in general government spending—that targets an elimination of the primary deficit by 2019—would allow a more balanced policy mix and create space for a reduction of the tax burden. Primary current spending accelerated over the last decade (rising 14½ percentage points of GDP between 2006 and 2017). Key measures that can be taken to rationalize spending include:

Change in General Government Primary Spending, 2006–17
(Percent of GDP)

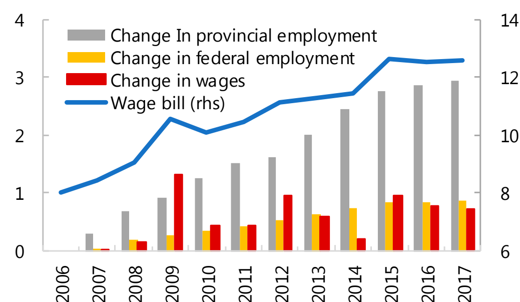


Source: Fund staff calculations.

- ***Reducing public employment.*** About two thirds of the 4½ percent of GDP increase in the wage bill between 2006 and 2017 reflects greater employment at the provincial level. As a result, in 2017, Argentina's public sector employment absorbs 2½ percent more of the labor force than the EM average. Assuming an attrition rate of 4 percent per year, a policy to replace only half of those employees that are exiting could reduce the wage bill from 12½ percent of GDP in 2017 to about 9 percent in 2027 (i.e., close to 2006 levels). A more

frontloaded reduction strategy, based on hiring freeze over the next two years, would reduce the wage bill by 1 percent of GDP by 2019.

General Government Wage Bill and Contributions to the Increase Since 2006
(Percent of GDP)



Sources: MECON, ASAP, and Fund staff calculations.

- ***Addressing pension imbalances.*** There is a need to restore the long-run sustainability of the pension system (see 2016 Article IV). To protect the elderly poor, the government should provide a means-tested, non-contributory, social transfer that is financed by general revenues. This would be complemented with a contributory pension scheme, financed from payroll taxes, but without the existing structure of special regimes and exemption (Box 1). More immediate savings could be achieved by indexing the existing defined contribution benefits to forward inflation. Together with increasing the statutory retirement age for women from 60 to 65 years, this would reduce federal pension spending by 2 percent of GDP. If similar measures were adopted by provinces, general government spending could fall an additional ½ percent of GDP by 2027.

- ***Rationalizing social assistance spending.*** Social protection in Argentina relies on multiple programs offered both at national and provincial levels by several different institutions. Integrating and coordinating the provision of services (for example, by introducing a unique social registry, see OECD 2017) could reduce duplication, improve targeting, and lower administrative costs.[1] Indexing benefits to future inflation could reduce spending on social programs by around ½ percent of GDP by 2027.

- ***Reducing other current spending.*** Recent plans to better coordinate goods and services purchases across all levels of public administration, including by making better use of information technology, are likely to generate cost savings. There is scope to cut spending on goods and services and provincial transfers to municipalities as well as lower federal transfers to public enterprises. Bringing back this expenditure to 2006 levels (of about 5 percent of GDP) would require savings of 2½ percent of GDP. A more frontloaded reduction (that implies reducing this expenditure by about 4 percent in real terms over the next two years) would allow savings of about 1½ percent of GDP by 2019.

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[1] OECD, 2017, *OECD Economic Surveys: Argentina 2017: Multi-dimensional Economic Survey,* OECD Publishing, Paris. Available via Internet at: http://dx.doi.org/10.1787/eco_surveys-arg-2017-en.

Box 1. A Two-Pillar Pension System for Argentina

Argentina's pension system is actuarially unbalanced reflecting population aging, high replacement rates, low retirement age for women, and an indexation formula that increases benefits above inflation (see 2016 Selected Issue Papers). In addition, the system has only a weak link between contributions and benefits: those who contribute for less than 30 years receive a basic pension equivalent of 80 percent of the minimum contributory pension, while those who contributed 30 years are entitled at least to minimum contributory pension, even if they contributed very small amounts. The current system acts as a disincentive to work in the formal sector, as contributions are closer to a "pure tax", and presents significant horizontal inequities.

A two-pillar option. A more efficient, equitable, and sustainable pension system could be based instead on:

- *A safety-net benefit,* extended to elderly of age 65 and above, funded by general revenues, and means tested. For example, the benefit could start from the basic pension (which is 25 percent of average wage) but be phased out for retirees with income (capital, rental and labor income) that is more than 70 percent of the average wage. Such a scheme would provide a safety net for elderly individuals currently in the bottom three deciles of the wage distribution. Means-testing could also be designed to consider wealth as well as income.

- *A mandatory contribution-based pension system*, with contribution rates set at 10 percent for both employers and employees (see Chapter 1 of the Selected Issues Paper) and a retirement age of 65 for all. There are a few options that could include:

  a) *A Notional Defined Contribution (NDC)* pay-as-you-go system. Social security contributions (excluding those that cover health insurance and *obras sociales*) would be recorded in a notional account, which grows based on an index that could be linked to nominal GDP growth (as in Italy), or per capita wage growth (as in Sweden). At retirement, beneficiaries would receive an actuarially balanced annuity from the proceeds contained in their notional account. There could be a cap on both contributions and the size of the notional account.

  b) *A mandatory fully-funded defined contribution system*. Social security contributions would accumulate in an individual saving accounts, managed by a private fund chosen by the worker. At retirement, the full amount saved can be drawn on tax-free or converted into a fixed, or variable, annuity (as in Australia, Chile, and Mexico).

Steady-state cost. We approximate the budgetary cost of a safety-net benefit and a NDC plan as follows:

- *Safety-net*: Based on the current basic pension, the first pillar could cost around 1.5 percent of GDP.

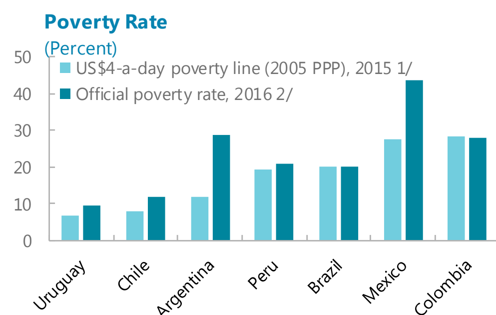
- *NDC plan*: A 20 percent contribution rate would yield around 4.8 percent of GDP in notional contributions. Assuming that the notional accounts grow with an index linked to nominal GDP growth, adjusting for current number of contributors, drawing on the United Nations' demographic projections, using the distribution of wages in the Household Survey, and assuming the contribution densities estimated in Apella (2010)[1] pension spending under the NDC system is estimated at about 4.3 percent of GDP. In steady state, the new system would cost 2 percent of GDP less than the current (2018) pension system.

Total Savings (percent of GDP)

Net cost of current system	**3.1**
Total pension spending (2018)	10.1
Contributions (2018)	7.0
Net cost of two-pillar system	**1.0**
Safety-net benefit	1.5
NDC	4.3
Contributions to NDC	4.8
Total net saving	**2.1**

1/ Apella, I., 2010, *Historias Laborales y Frequencia de Contribuciones a la Seguridad Social en Argentina*, Asociacion Argentina de Economia Politica, November.

11. It will be important that the proposed shift in the policy mix is accompanied by measures to mitigate the effects on lower income households. With one third of the Argentina's population in poverty, it is essential to mitigate the impact on the poorest from the needed fiscal adjustment. While much of the improvement in poverty outturns will come from more sustained and stronger growth and the creation of good quality jobs, the simultaneous adoption of a few policy measures will help:



Sources: SEDLAC (CEDLAS and The World Bank), INDEC, and country authorities.
1/ Mexico (2014); 2/ Argentina (2017Q2), Brazil (2015), and Chile (2015).

- A subsidized tariff to protect the poor from the planned elimination of subsidies (the *tarifa social* introduced last year by the authorities, which reduces the cost of gas, water, electricity and transportation for the most vulnerable segments of the Argentine population).

- Protecting the basic pension in real terms. It is notable that, at 7½ percent, the poverty rate for elderly is much lower than for the whole population (as a result of the significant increases in pensions over the last several years).

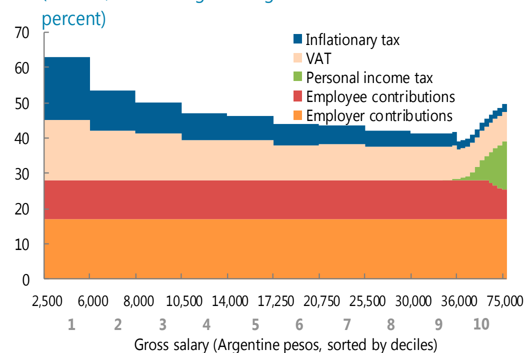
- Reducing payroll taxes and expanding the coverage of personal income taxes since currently only the top 10 percent of the income distribution pays the personal income tax (see Chapter 1 of the *Selected Issue Papers*).

- Phasing out family allowances more rapidly (so that they are fully eliminated at the average wage, as opposed to 1.5 times the average wage as in the current system).

- Introducing a cash transfer to those in the bottom decile of the income distribution (equivalent to about 50 percent of the current minimum wage) (see Chapter 1 of the Selected Issues Paper).

- Lowering inflation, since the inflation tax is extremely regressive.

Incidence of Selected Taxes over Labor Income
(Percent, relative to gross wage with inflation at 23 percent)



Source: BCRA.

12. Staff simulations suggest that the proposed fiscal path would lower real interest rates, reduce the external financing requirement, and lessen appreciation pressures on the peso (Figure 4). The pace of disinflation would be the same—as the economic costs of a tighter fiscal policy stance would be balanced by lower real interest rates and a less appreciated real exchange rate—and the debt-to-GDP would be placed firmly on a downward path.

Figure 4. Argentina: Baseline and Illustrative Scenario 1/

Source: IMF staff estimates.

1/ The *Frontloaded spending and tax cuts* scenario includes freezing public sector hiring in 2018-19; indexing social transfers and pensions to targeted inflation; lower spending on goods and services, transfers to provinces, and state-owned enterprises; phasing out (over a three-year period) the financial transaction tax and the provincial gross turnover tax (to be replaced by a sale tax and higher property taxes); reducing the corporate income tax rate to 28 percent; and a reform of labor income taxation as discussed in Box 3.

13. The new Fiscal Pact with provinces encourages fiscal discipline and addresses some long-standing distortions. Provinces are responsible for about 40 percent of general government spending and, like the federal government, their footprint has increased markedly in the past several years. As a first step, the proposed Fiscal Responsibility Law will help provide a framework to contain spending, as the bill caps the growth of current primary spending in real terms (although with a few exemptions), contains provincial hiring to population growth, prohibits an increase in spending during the last six months of government, and includes a commitment to not raising the tax burden and to create countercyclical fiscal funds. The new Fiscal Pact with provinces, signed in mid-November, also commits provinces to gradually (over a 5-year period) reduce the rate of the gross turnover tax, a highly distortionary cascading tax, eventually eliminating it for a few sectors; settles the conflict between the federal government and provinces related to the sharing of income tax revenues, eliminating contingent liabilities for the federal government that the authorities estimate to be in the order of US$40 billion; and commits provinces to extend the Fiscal Responsibility Law to municipalities.

14. The institutional framework for fiscal policy needs further strengthening, including by:

- ***Enforcement of the Fiscal Responsibility Law.*** To be effective, the law needs stronger enforcement mechanisms. The proposed framework relies on preventing provinces from issuing debt and imposing cuts in discretionary transfers in the case of non-compliance. One possibility would be to automatically exclude provinces in violation of the law from receiving discretionary transfers from the federal government. The law should also define more clearly what types of provincial spending are subject to caps, and the exemptions to the spending limits embedded in the law should be narrowed.

- ***Introducing a medium-term debt target.*** The Fiscal Responsibility Law should have a clear medium-term fiscal anchor, which could be a debt-to-GDP ratio for the federal government and a debt-to-total revenue ratio for provinces. There should be a direct link between the chosen anchor and the operational targets of the FRL, limited and transparent escape clauses from targets, and a requirement that the escape clause lead only to temporary deviations from the medium-term debt path (i.e., that deficit overruns should be recouped over time).

- ***Budget framework.*** The federal government could usefully provide budget forecasts for the next three years (as mandated by the current budgeting law), including details on the policies that are expected to achieve the chosen medium-term goals. Budget documents should include an analysis of fiscal risks, which will prove particularly useful if the government achieves its goals of increasing the use of PPP projects and reforming public pensions.

- ***An operationally independent Congressional Budget Office.*** This new office was created at end-2016 to analyze and evaluate the fiscal impact of proposed legislation. It will be important to ensure the office is autonomous, adequately staffed, and has full operational independence—including over its budget—to protect the office's assessments from political influence.

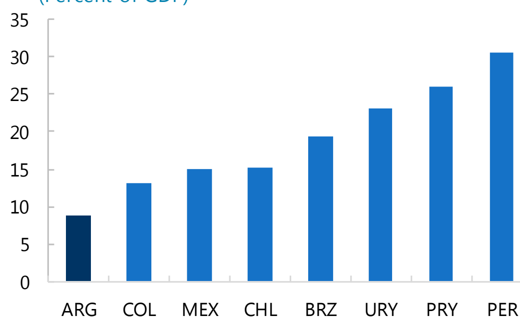
15. *Authorities' view*. The authorities noted that rationalizing spending is a key policy objective but it will need to proceed at a measured pace. They emphasized that, net of one-off revenue, the primary deficit of the general government—including provinces—is about to decline by 1.5 percent of GDP in 2017, and that primary expenditure has decreased by about 2 percent of GDP since 2015, with taxes being cut by an equivalent amount. Improved transparency and better procurement processes have resulted in cost savings and more efficient spending on public works. Federal employment fell by 4 percent in 2017, but there is space to gradually rationalize the wage bill further, especially in provinces. Efficiency gains will be pursued at all levels of administration through an analysis of the optimal allocation of resources, and cost savings are expected from having ANSES administer the payment of all social programs. Also, the authorities are planning to send a bill to Congress to change the indexation formula for pensions and social transfers linking them to inflation only, making them more sustainable and ensuring stable real income to the recipients. A more comprehensive reform of the pension system will be proposed in 2019. While mindful of the budget constraint, the authorities noted that about 60 percent of general government expenditure is in wages and social transfers, which prevents a fast adjustment of the fiscal deficit. A more realistic and sustainable scenario is one where primary spending is kept flat in real terms, in line with the proposed new Fiscal Responsibility Law. If growth can be sustained at 3½ percent, this will reduce general government expenditure from about 40 percent of GDP in 2017 to 32 percent by 2023, which would fund a reduction of the tax burden (of about 3 percent of GDP) and bring the primary deficit to zero.

B. Monetary and Exchange Rate Policy

16. Reducing inflation remains a key priority for the government and doing so will require a continued restrictive monetary stance. Even though real ex-ante short-term interest rates are high (Figure 5), the pace of disinflation is relatively slow due to lingering *de-facto* inertia in wage formation, a weak monetary transmission mechanism, and second round effects from the tariff adjustment. A faster pace of disinflation would impose a significant cost on growth and employment, and would be not advisable. However, as discussed above, once a larger reduction in the fiscal deficit has begun, this would facilitate a faster reduction in real interest rates, mitigating the growth impact of the fiscal consolidation while maintaining inflation on a steady (albeit slower-than-targeted) downward path. A faster pace of fiscal consolidation would also allow the BCRA to eliminate monetary financing of the fiscal deficit. Once this happens, the institutional structure should be changed to prohibit future central bank financing of the government. This would help strengthen the credibility of the BCRA's inflation targeting framework and lower inflation expectations.

17. Sustained FX reserve accumulation should be deferred until the disinflation process is more fully entrenched. The BCRA intends to increase FX reserves from about 8¾ to 15 percent of GDP over the next few years, to bring Argentina's reserve coverage closer to other countries in the region. If this target was achieved by end-2019, this will take FX reserves to 165 percent of the IMF's reserve adequacy metric (from the current 115 percent). Increasing FX reserves is a necessary objective for a country traditionally exposed to bouts of external volatility like Argentina. There is also merit to BCRA's intention to use limited FX intervention to prevent disorderly market conditions and smooth excessively rapid movements in the exchange rate. However, a sustained increase in FX reserves—either through market purchases or absorbing the FX proceeds of government external borrowing—may weaken the nominal exchange rate and slow the decline in inflation. As such, at this point, the BCRA should prioritize its inflation objectives, with reserve accumulation goals subordinated to achieving a more entrenched path for disinflation.

FX Reserves, October 2017 1/
(Percent of GDP)

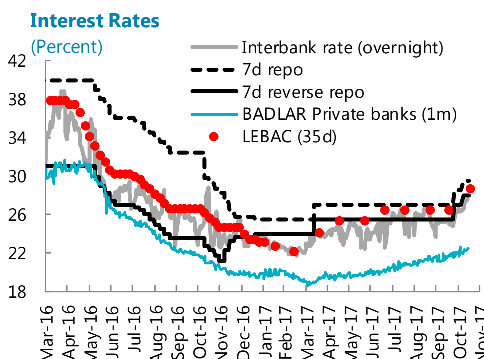


Source: Fund staff calculations.
Note: 1/ Data for GDP refer to 2016Q3–2017Q2.

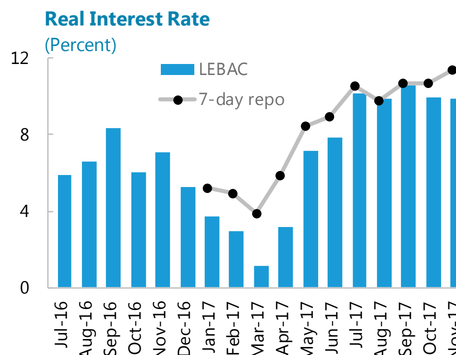
18. *Authorities' view*. The authorities stressed that they remain committed to maintaining a tight monetary policy stance in order to achieve their inflation targets. In their diagnosis, the loosening of the policy stance in the first quarter of 2017 proved to be premature, leading to high inflation and a rise in inflation expectations. The effects of the subsequent monetary tightening may take time to materialize, especially given excess liquidity in the financial system after the inflows from the tax amnesty. Tariff adjustments continue posing headwinds to disinflation. The BCRA does not have a specific timeline to achieve the stated FX reserves target of 15 percent of GDP and will continue to build reserves in a balanced way. The authorities emphasized that disinflation remains the primary objective. As reserve rise, the BCRA may eventually start selling some of the foreign exchange obtained from external public debt issuances (the BCRA acts as the financial agent for the government). The BCRA remains committed to a flexible exchange rate regime.

Figure 5. Argentina: The Monetary Policy Stance Has Tightened

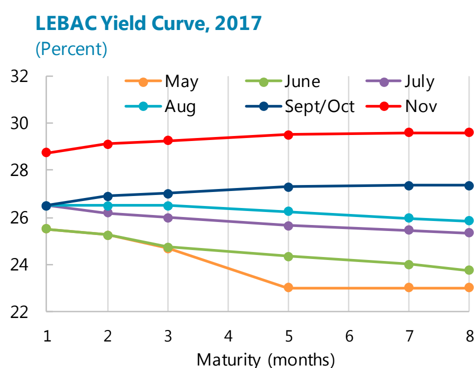
BCRA kept the policy rate unchanged since April, before hiking the rate 250 basis points in October-November.



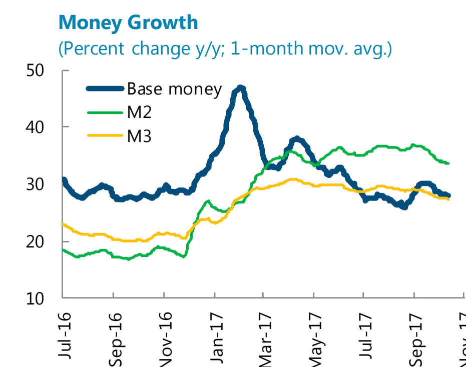
Real interest rates have increased sharply in 2017.



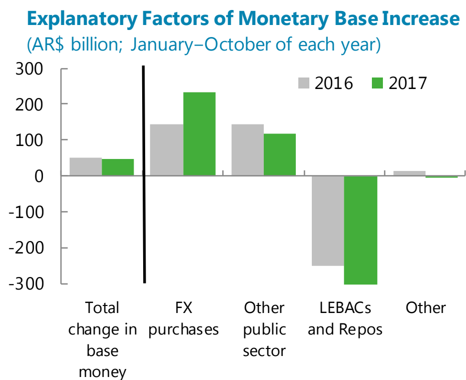
Moreover, the BCRA has increasingly flattened the LEBAC yield curve.



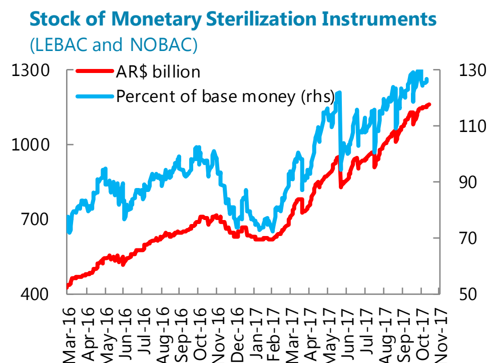
Monetary base growth has slowed since the peak early this year, but remains relatively high.



Fiscal financing has been the main source of money creation.



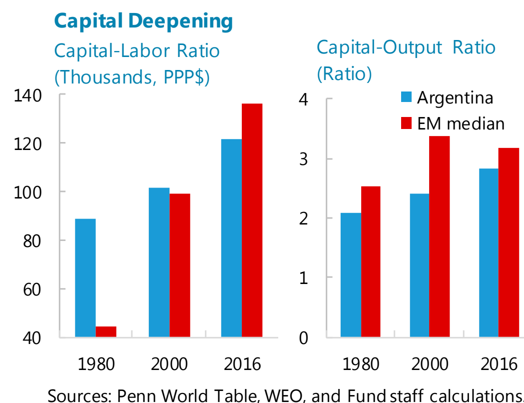
Sterilization efforts have resulted in further build-up of the stock of LEBACs.



Sources: Banco Central de la República Argentina (BCRA) and IMF staff calculations.

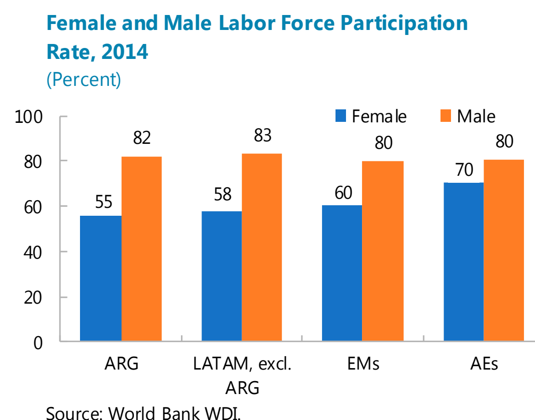
THE URGENCY OF SUPPLY–SIDE REFORMS

19. Achieving a stronger, sustained, and equitable growth path will hinge on boosting private investment and raising productivity growth. Decades of frequent crises and recurrent government interventions in the economy have resulted in significant macroeconomic volatility, a premium for policy risk, and low levels of both investment and potential growth. Argentina's capital-labor and capital-output ratios are well below the EM median, and the infrastructure gap is particularly severe (especially in the transportation and energy sectors). Argentina also has to contend with declining labor force participation (due to demographics) and a particularly low participation rate for women and the young. Finally, average labor productivity growth since 1980 has been close to zero (versus an EM average of 2½ percent).



Sources: Penn World Table, WEO, and Fund staff calculations.

20. There is significant space to undertake supply side reforms to strengthen private investment and productivity. Business conditions have improved under the new government but a better tax system and more effective labor and product market regulations are urgently needed. If tax, labor and product market (including trade) reforms were implemented that close half the gap with the EM average in each area, potential growth could be increased by 1½ percent (Box 2). Productivity boosting supply-side reforms would also reduce currency overvaluation and help mitigate inflationary pressures.



Source: World Bank WDI.

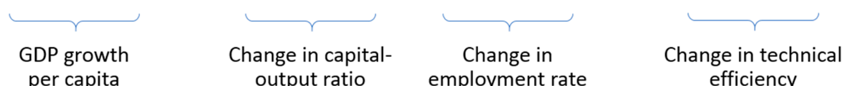
A. A Less Distortionary Tax System

21. Taxes in Argentina are high and distortionary. Taxation of labor income in Argentina is one of the highest in Latin America and close to the OECD average. The tax wedge on labor income (defined as the difference between the gross wage and take-home pay) arises mostly from social security contributions, given that the personal income tax covers only the top 10 percent of the income distribution (due to a minimum threshold that is twice the average wage). Lowering the tax wedge on labor would help strengthen incentives to work and discourage informal employment, particularly for low-income workers and second earners. The corporate tax is high (the statutory rate is 35 percent compared to an average for the region of

Box 2. Impact of Structural Reforms in Argentina: A Supply-Side Approach[1]

The long-term potential impact of structural reforms on Argentina's growth is estimated using a supply-side framework. Following Égert and Gal (2016)[2], we assess the role of reforms (denoted *z* in the equation below) in boosting GDP per capita through their impact on capital accumulation, labor utilization, and an estimated measure of technical efficiency. The sample contains 32 EMs (including seven Latin American economies) and 27 advanced economies with data ranging from 1980 to 2016.

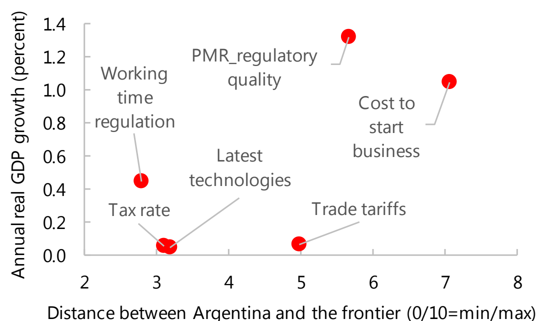
$$\Delta ln\left(\frac{Y}{N}\right) = \frac{\alpha}{1-\alpha}\Delta ln\left(\frac{K}{Y}\{z\}\right) + \Delta ln\left(\frac{E}{WP}\{z\}\right) + \frac{1}{1-\alpha}(\Delta TE\{z\})$$



The paper finds that structural reforms can have a significant impact on long-term GDP growth through all three supply-side channels. The largest effect of structural reforms generally comes through the productivity/efficiency channel. Regulatory changes that promote competition and ease labor market regulations matter the most. Pro-competition regulation together with lower tax rates on income and payroll appears to improve labor utilization. Lower costs of starting a business and trade tariffs are especially important for capital accumulation.

Structural reforms could have substantial effects on Argentina's long-term GDP growth. Policies to promote capital and labor utilization offer the largest payoffs, given the size of the gaps accumulated in both areas. Reducing trade tariffs and payroll taxes to close half the gap with countries on the frontier could add about 0.1 percentage points to real GDP growth per year, while an ambitious reform effort to improve Argentina's business regulatory environment could boost real GDP growth by about 1 percent per year. While there is large uncertainty around these estimates, OECD (2017)[3] finds that if Argentina were to implement a wide range of structural reform to converge to the OECD average over a ten-year period, the annual growth rate could increase by 1½ percent.

Structural Reforms and GDP Impact



Source: IMF staff estimates.
For each policy variable, the chart shows Argentina's distance from the frontier and the estimated increase in annual growth rate of real GDP if half of the distance is closed in twenty years.

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[1] See Lusinyan L., 2017, *Assessing the Impact of Structural Reforms through a Supply-side Framework: The Case of Argentina*, Chapter 2 of the Selected Issues Paper.

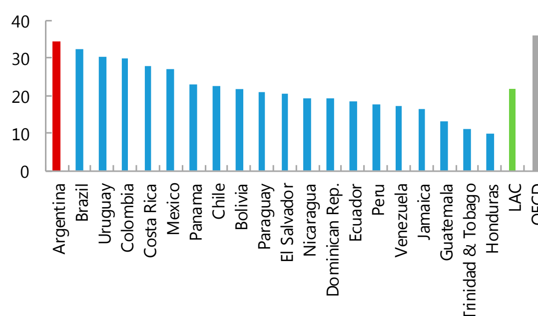
[2] Égert, B., and P. Gal, 2016, *The Quantification of Structural Reforms in OECD Countries: A New Framework*, OECD ECO/WKP(2016).

[3] OECD, 2017, *OECD Economic Surveys: Argentina 2017: Multi-dimensional Economic Survey,* OECD Publishing, Paris.

28 percent). The financial transaction tax (levied on checking and saving accounts) and the gross turnover tax (a cascading provincial sales tax)—which together account for 5½ percent of GDP in revenues—are both highly distortionary. There is a complex system of VAT exemptions and deductions, and Argentina has low property taxes compared with other countries in the region.

Total Tax Wedge, 2013

(Percent of labor cost)



Sources: Organization for Economic Cooperation and Development, and Fund staff calculations.

22. The authorities have proposed a tax reform to address many of these issues. A bill was sent to Congress in November that improves Argentina's tax system along several dimensions and phases in a series of changes over a five-year horizon:

- ***Reducing the tax burden on investment.*** The reform reduces the statutory corporate tax rate from 35 to 25 percent for reinvested earnings and accelerates the reimbursement of VAT on investment. Combined with a proposal to revalue the value of assets in line with past inflation, the reform would reduce the tax burden on capital closer to the regional average.

- ***Lowering the marginal tax rate on labor income for low and middle-income earners.*** The reform transitions over the next five years to a system that exempts employers from paying social security contributions on the first 12,000 pesos of the monthly wage, introduces a single contribution rate of 19.5 percent for all employers, and removes the existing income cap on employee contributions. The tax wedge on labor income would decline, on average, from 27 to 19 percent.

- ***Reducing cascading taxes.*** The reform allows the full deductibility of the financial transaction tax from income taxes. The new fiscal pact with provinces envisages (within five years) reducing the gross turnover tax. The City and the Province of Buenos Aires have already announced their intention to reduce the rate of the turnover tax and increase property taxes to help cover part of the revenue losses.

- ***Taxing capital income and carbon.*** The reform introduces a tax on financial income above a certain threshold (Argentina is one of few countries in the region without any tax on financial income earned by individuals), a tax on capital gains from the sale of real estate properties, and a carbon tax.

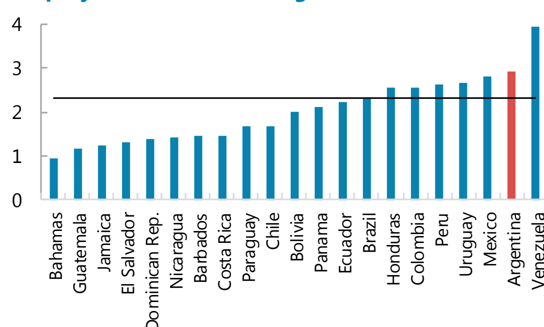
Staff estimate that the revenue loss from the government's reform, after five years, will be about 3¾ percent of GDP (1½ percent from the reduction of the gross turnover tax and 2¼ percent from the other measures). Caution is warranted in relying on uncertain growth effects to offset the revenue losses from the tax reform.

23. The authorities' proposed tax reform is a good step forward to overhaul Argentina's inefficient tax system. The proposal gradually lowers the effective tax rate on labor income for low-income workers, increases the progressivity of the system, and reduces the disincentive to formal employment. However, the reform could go even further and lower the payroll tax rate while expanding the coverage of the personal income tax to bring at least the top quintile of the income distribution into the tax system (Box 3). The gradual reduction of the statutory tax rate for reinvested corporate earnings should help support investment, but more generous depreciation allowances (or even expensing of new investments) and more generous provisions for carrying forward losses would further reduce the effective tax on capital. The deductibility of the financial transaction tax will help lessen distortions that hold back financial deepening and financial inclusion, but a full elimination of the tax would be preferable. Eliminating the gross turnover tax will support investment, growth, and job creation.

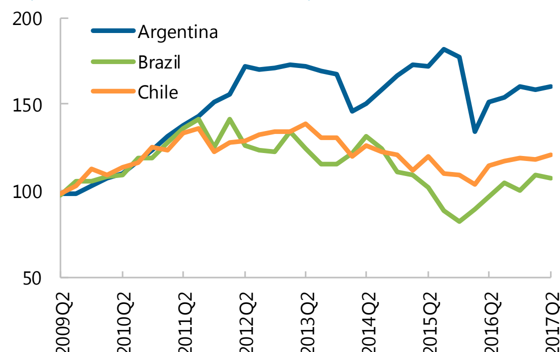
24. *Authorities' view*. The authorities estimate that, excluding the change in the gross turnover tax, the tax reform will have an overall direct cost of 1.5 percent of GDP by 2022. However, they also estimate that it will boost GDP growth by 0.5 percent per year, and that the additional revenues from stronger economic activity will help reduce the overall cost to just 0.3 percent of GDP for the federal government (whereas provinces would benefit by an aggregate 0.6 percent of GDP). The gradual elimination of the gross turnover tax at the provincial level is estimated to cost 1.5 percent of GDP in 5 years. The authorities were confident that the spending caps included in the proposed Fiscal Responsibility Law will give provinces enough space to absorb the revenue losses and eliminate the fiscal deficit in the next few years.

B. A More Flexible Labor Market

25. Argentina has relatively rigid labor market institutions and regulations. OECD indicators suggest Argentina has more inflexible labor market regulations than both Latin America and OECD averages. The main shortcomings include high termination costs, complex procedures for collective dismissals, and restrictive conditions for temporary employment (including for part-time work and apprenticeships). Collective bargaining is also an issue—it takes place at the sectoral level and covers about 70 percent of workers (even though only 30 percent of workers are unionized). Pressures to modernize Argentina's labor market institutions have increased given recent reforms in Brazil (Argentina's principal trading partner) which will lower its unit labor costs.



Sources: OECD Employment Protection Database and Fund staff calculations.
1/ 2013 for CHL and MEX.



Sources: INDEC, BCRA, BCB, and Fund staff estimates.

Box 3. Reducing Argentina's Tax Wedge[1]

Estimating the tax wedge. Using the Household Survey, the social security contribution rate average 21 percent of the gross wage for employers and 15 percent for employees (which includes 6 and 3 percent respectively for contributions to *obras sociales*). However, there is a lot of heterogeneity, with numerous variations across sectors and regions. Since only high wage workers pay personal income taxes, the system means that (i) labor is effectively taxed at the flat rate of 45 percent of the gross wage for most of the working population, and (ii) taxes average 27 percent of the cost of labor. The net cost of formalizing a labor relation is close to 20 percent of the gross wage for a second earner, and is close to 23 percent for workers in the first decile of the wage distribution.

A reform proposal. A package of measures would reduce disincentives to work, lower informality, and increase competitiveness:

- Lowering social security contribution rates for both the employees and the employers to 10 percent of the gross wage (with an additional 9 percent combined rate for *obras sociales*);
- Eliminating all sectoral and location-based discounts to social contributions;
- Increasing the coverage of the PIT to the top two deciles of the income distribution, by lowering deductions for non-taxable income;
- Phasing out family allowances at the average wage (instead of at 1.5 times the average wage); and
- Providing income transfers of about fifty percent of the minimum wage (*salario minimo vital y movil*) to all workers in the bottom 10 percent of the wage distribution.

Effects. The proposed reform would lower the average tax wedge by 9 percentage points and bring it to zero for the bottom decile of wage-earners. The net cost of formalizing labor relations would fall by 13 percentage points for low wage earners and by 8 percentage points for second earners. The average payroll tax rate for employers would fall by 6 percentage points. The reform would have a net cost of 0.3 percent of GDP, would increase formal employment by 3.4 percent, and raise long-term output by 1.2 percent. A dynamic costing, incorporating supply-side effects to growth, finds the reform to be broadly revenue neutral.

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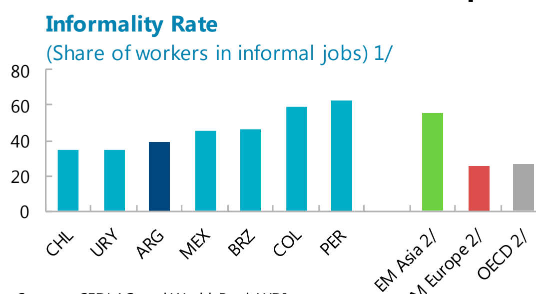
[1]See Dudine P., Fenochietto R., Malta V., and Mendes Tavares M., 2017, *How to Reduce Argentina's Tax Wedge*, Chapter 1 of the Selected Issues Paper.

26. A comprehensive reform of labor market institutions is needed. The authorities are already working—within sector-specific wage agreements—to create more flexible working conditions, reduce absenteeism, and provide more on-the-job training. Beyond this, legislative changes should focus on: (i) streamlining dismissal procedures and reducing uncertainty regarding lay-off costs (ii) lowering the level of required severance payments; (iii) simplifying collective dismissal procedures; (iv) facilitating the use of temporary contracts (including apprenticeships) and part-time work arrangements; (v) limiting the extension of coverage of collective bargaining agreements beyond the direct signatories; and (vi) offer a wider use of opt-out clauses from collective bargaining (rather than the current presumption that the agreement would cover all firms in a particular sector independently on the degree of unionization). In addition, the current level of the minimum wage is likely to be an incentive to work in the informal sector (it is currently 45 percent of the median wage and covers about one third of the labor force, and about half of informal workers). Indexing the minimum wage to targeted inflation would allow for a better balance between encouraging workers to enter the formal labor force while still protecting the poor.

27. Lower taxation of labor income and better labor market institutions will help lessen informality and increase female labor force participation. In 2016, informal employment accounted for between 30 and 40 percent of workers (see Chapter 3 of the Selected Issues Paper). Informality in Argentina disproportionately affects the undereducated and the young (both of which are at the bottom of the income distribution) and women (creating a gender bias in the labor market). Lower taxes and greater labor market flexibility can help reduce informality and, in doing so, reduce poverty and increase female labor force participation (Box 4). Changes in labor taxation should particularly focus on eliminating the tax wedge for second earners, removing an important obstacle for women's participation in formal labor markets. Easing restrictions on temporary employment would facilitate access to labor markets, particularly for young and female workers. There is also significant scope to improve active labor market policies, especially training, job search assistance, and education programs (perhaps as a condition for receiving existing cash transfers).



Sources: SEDLAC and World Bank WDI.
1/ Salaried workers in a small firm, a non-professional self-employed, or a zero-income worker. 2016 for ARG, BRZ, CHL, COL, MEX; 2014 for PER and URY.
2/ Unregistered and/or small-scale private firms (street vendors, taxi drivers and home-base workers are considered as firms). Agricultural, and related activities and volunteer services are excluded. Last observation per country (2009–15).

28. *Authorities' view*. The authorities said that they were considering a series of changes that would reduce informality and foster job creation. These include a "labor amnesty", that exempts firms that formalize unregistered workers from paying fines and past obligations to the social security administration. In order to reduce the risk of litigation related to dismissal of workers, the penalties that can be added to severance payments ((for any violation of labor contracts) would be reduced and directed to the social security system, rather than the employees. The authorities are also considering introducing sectoral severance funds, to which

firms could choose to participate in order to guarantee the immediate availability of funds for severance payments. Other changes under consideration include the introduction of apprentiship contracts that can last up to one year (the current maximum is three months); greater flexibility for workers with children under the age of four; longer paternity leave; and an extended unemployment insurance for cases of productive restructuring. A bill with these measures was sent to Congress in mid-November.

Box 4. Gender Bias in Argentina's Labor Market[1]

Argentina' labor market is characterized by gender inequality along three main dimensions:

- ***Low female labor force participation rate***. Female labor force participation rate is lower than most other Latin American countries, and the gap between male and female participation has been unchanged since the early 2000s.
- ***Women are more likely to work in the informal sector***. According to the Household Survey, in 2017, 39 percent of the women in the labor force work in the informal sector (versus 34 percent for men). Informal jobs are characterized by lower earnings, poor employment conditions, lack of protection, compulsory overtime or extra shifts, lay-offs without notice or compensation, unsafe working conditions and the absence of social benefits, such as health insurance, sick pay, and maternity leave. The Household Survey shows that hourly pre-tax wages are on average 50 percent lower in the informal sector than in the formal sector, which represents one of the largest gaps among emerging economies (OECD, 2015c).
- ***A high wage gender gap***. The overall gender wage gap is 24 percent in Argentina. This gap can reflect different working conditions and job characteristics between genders. However, after controlling for a series of observable individual and job characteristics (such as age, education, sectors, location, and occupation), a 14 percent wage gender gap remains. For workers in the informal sector, the wage gender gap is much higher at 27.5 percent (after incorporating the same set of controls).

To analyze the impact of reforms on economic growth, income inequality, and female labor force participation, staff use a dynamic general equilibrium model with heterogeneous agents. The policies considered are (i) a reduction of the tax wedge on labor income as proposed by staff (Box 3) (ii) measures that reduce wage discrimination against women, and (iii) a subsidy to childcare to low- and mid-income formal female workers, to encourage participation. The results suggest that all these measures would increase female labor force participation in the formal sector and boost long-term GDP (by 12 percent and 1 percent, respectively, in the case of a lower tax wedge).

[1] See L. Kolovich, V. Malta, M. Mendes Tavares, 2017, *Gender Bias in Argentina's Labor Market*, Chapter 4 of the Selected Issues Paper.

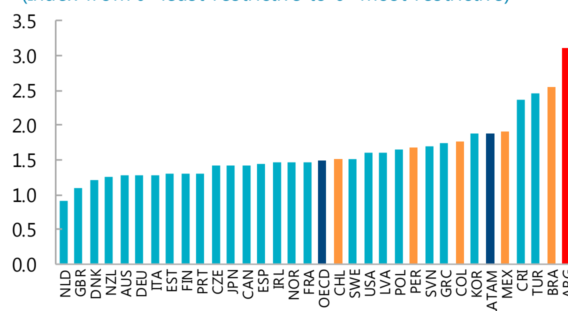
C. Better Product Market Regulations

29. There is a need to reduce barriers to trade and foreign investment. Argentina continues to maintain significant barriers to trade (in the form of both tariff and non-tariff barriers) and to foreign investment (including through the discriminatory treatment of foreign suppliers in various sectors). Import tariffs are nearly three times higher than the EM average (and around seven times greater if non-tariff measures are added). Although import licensing has been simplified and made less discretionary, about 1,600 products remain subject to import licenses. Argentina's membership in Mercosur constrains its ability to unilaterally lower tariffs but, even within those constraints, there is still scope to: (i) reduce the average level and dispersion of

import tariffs; (ii) further scale back non-automatic import licensing requirements to cover a minimum of goods (for national security or public safety reasons); and (iii) work within Mercosur to negotiate a broader reduction in barriers to trade.

30. Reforms should remove entry barriers and product market regulations that restrict competition and investment. Argentina underperforms most of its peers in nearly all dimensions of product market regulation. Recent assessments from the OECD (2017) and the World Bank (forthcoming) identify significant constraints to competition from various forms of state controls, including through regulatory protection of state-owned enterprises and private sector incumbents as well as residual forms of price controls.[2] These constraints should be quickly phased out, and barriers that limit market entry should be eliminated. Passage of the draft Competition Law (in Congress since last year) would improve the framework and give more autonomy and powers to the Competition Authority.

Restrictiveness of Product Market Regulations 1/
(Index from 0=least restrictive to 6=most restrictive)



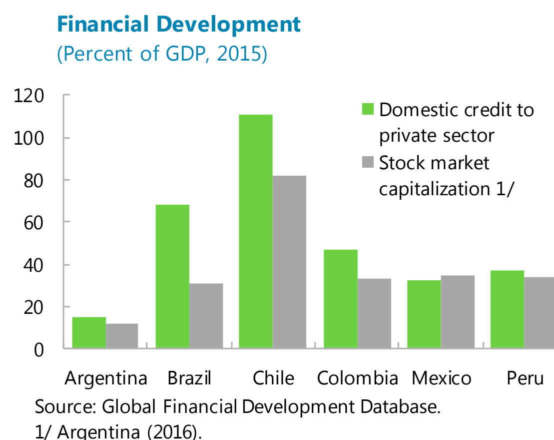
Source: OECD Product Market Regulation Database.
Note: 1/ Data are for 2013 or last available year; data for Argentina are preliminary and refer to 2016.

31. *Authorities' view*. The authorities consider reducing red tape and fostering competition essential to increase productivity. They noted that a few measures should bear fruit soon, including the Entrepreneurship Law (that allows firm to be set up in only one day), and a one-stop mechanism that should reduce administrative requirements on imports and exports (*Ventana Unica de Comercio Exterior*). A Secretariat of Productive Simplification will be created, and further measures will be taken to digitalize public administration and make various authorizations automatic, including through a "single window" concept. Noting that Argentina has trade agreements with only 9 percent of the world GDP (against Chile's 90 percent), the authorities emphasize the importance of integrating the economy in global value chains and advancing on EU-Mercosur trade agreement. They see the economic recovery as an opportunity to gradually (unilaterally within Mercosur) reduce trade tariffs and non-automatic import licenses. The authorities said they are focusing on cartel investigation, especially in public procurement, and are confident the Competition Law will be approved soon.

[2] Licetti, M. and others (forthcoming) "*Strengthening Argentina's Integration in the Global Economy: Policy proposals for trade, investment and competition.*" The World Bank Group.

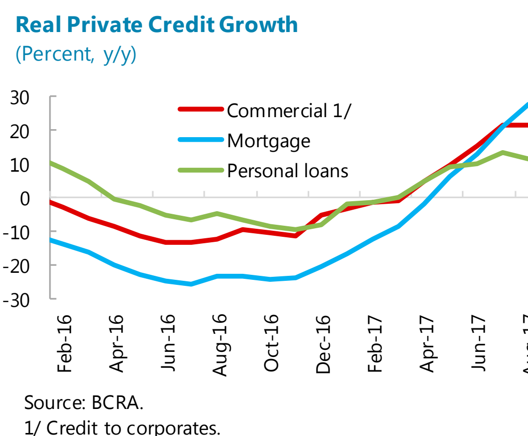
D. A Stronger and More Inclusive Financial Sector

32. A deeper, more developed system of financial intermediation would support capital formation, growth, and financial inclusion. Argentina's financial system is small, with the size of bank credit to the private sector and level of stock market capitalization well below other Latin American countries. Policies are needed to better intermediate savings to productive investments including by developing bond and equity finance markets. One positive step would be to pass the Capital Markets Law (sent to Congress last year), which would modernize the capital market regulatory framework, improve corporate governance, widen the supply of financial assets, and promote the development of domestic institutional investors. There is also a large potential to increase financial inclusion by extending banking services to a greater share of the population (less than 50 percent of the population has access to a bank account—a much lower percentage than in other Latin American countries).



Source: Global Financial Development Database.
1/ Argentina (2016).

33. As the domestic financial system expands, there will need to be careful attention to ensuring systemic financial stability risks are contained. In 2017, credit growth has accelerated sharply, reflecting inflows into the domestic financial system from the 2016 tax amnesty (almost 20 percent of GDP) and policy measures to develop the financial system (including the introduction of an inflation-indexed accounting unit for credit contracts that has supported development of the market for mortgages). With inflation falling, banks are planning to further expand credit volumes to maintain their margins and returns on capital, necessitating an expansion in their deposit base. The banking sector is well capitalized and liquid, but vigilance will be needed to ensure that asset quality remains high as credit grows. Progress has been made on a few 2013 FSAP recommendations—including achieving full compliance with Basel III standards—but it would be important to continue strengthening financial supervision framework and tools.[3] Stress testing procedures should be



Source: BCRA.
1/ Credit to corporates.

[3] Argentina was assessed by the BCBS Regulatory Consistency Assessment Program (RCAP) in 2016 and found to be overall compliant with the Basel III framework. In August 2017, FSB completed its peer review of Argentina's macroprudential policy framework and the framework for crisis management and resolution, and concluded that while progress has been made in recent years, the institutional set-up for financial stability and resolution regime should be strengthened.

improved, with the BCRA better reconciling bottom-up and top-down stress tests. Data collection and analysis should be enhanced (particularly on real estate transactions, cross-border activities, and non-bank financial institutions), and the coordination across sectoral regulators and ministries needs to be strengthened, under the leadership of the BCRA.

34. ***Authorities' view***. The authorities consider financial deepening and inclusion a key policy objective. They are confident that the new Capital Market Law will be approved by end-2017. Credit growth is expected to continue next year but to slow in the future, as excess liquidity wanes (the subsidized credit line to small and medium enterprises will be phased out next year, in line with FSAP recommendations). Banks have tight loan-to-value and debt-to-income ratios, and are lending mainly to their own existing clients and for the purchase of first homes. Moreover, although mortgages are growing rapidly, mortgage-to-GDP ratio remains well below historical peaks. The establishment of a financial inclusion committee at the inter-ministerial level will give impetus to policies that foster access to banking and financial services. The committee will look at experiences of other countries which have significantly increased access to the banking system. A positive role is expected to be played by public banks (that have stepped up the provision of micro credits) and the introduction of a new financial instrument (*Obligación Negociable Simple Garantizada*) that should make it easier for small and medium enterprises to access capital markets.

E. Fighting Corruption

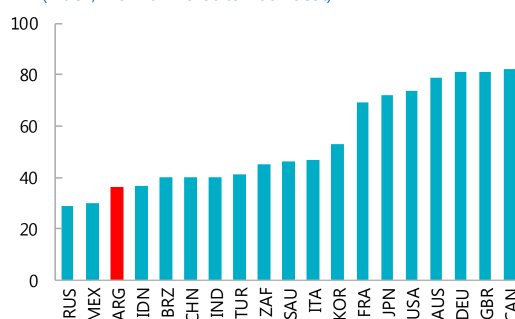
35. The authorities should continue strengthening the anti-corruption regime, focusing on its effective implementation and institutional framework. Important progress has been made since 2016 in this area, including on strengthening the legal framework, improving accountability and transparency standards for public procurement, and empowering anti-corruption and anti-money laundering institutions (Box 5). Going forward, fighting corruption and strengthening governance will require that the new laws and standards are effectively enforced, particularly by strengthening prosecutorial and judicial proceedings. The Anti-Corruption Office (ACO) needs to be given autonomy and financial independence. In addition, it would be important to further improve the financial disclosure regime (to include information about ultimate beneficial owner and assets held abroad, and increase information sharing from the judicial and legislative branches) and to approve the asset recovery law that is currently in Congress.

36. Authorities' view. The authorities stressed that fighting corruption, increasing transparency, and strengthening integrity are high priorities. To this end, they continue working on several fronts, including on: (i) a new public integrity law, which will give autonomy and power to the ACO; (ii) a roadmap to preempt collusion and corruption, including through a high-level hotline for the newly launched PPP program; (iii) strengthening corporate governance in about 40 state-owned enterprises, with the first guidelines expected to be presented in February 2018; (iv) a whistle-blower legislation; and (v) reforming the financial disclosure regime. The authorities attributed low level of implementation of the new laws (including of the Law of the Repentant) to

the need for better training of prosecutors and judges, better enforcement protocols, and a reform of the Penal Code.

Box 5. Anti-Corruption and Integrity Policies in Argentina

Argentina is perceived as a country with relatively high levels of corruption, inefficient public administration, and high degree of favoritism in decisions of government officials (Global Competitiveness Index, WEF).



Source: Transparency International.

Over the past two years, efforts to strengthen integrity and transparency and fight corruption in Argentina included:

- Passage of the Law of the Repentant (*Ley del Arrepentido*), which expands plea bargaining in corruption cases, and the Law on Access to Public Information (*Ley de Acceso a la Información Pública*) aimed at promoting transparency.
- Passage of the Corporate Liability Bill (*Ley de Responsabilidad Penal de las Personas Jurídicas*) making corporates liable for corruption crimes, including bribery of local public officials (in line with the OECD Anti-Bribery Convention).
- Sending a bill to Congress to facilitate the recovery of assets in cases of corruption.
- The government adopted regulations aimed at preventing conflicts of interest, establishing an obligation to disclose any relationships with high-level government officials or with officials responsible for procurement or authorization, and regulating gifts policy.
- The ACO has set up an ethics office (*Unidad de Ética y Transparencia de la Oficina Anticorrupción*) in the National Roads Directorate (*Dirección Nacional de Vialidad*), which has been looking into corruption cases, leading to administrative sanctions and dismissals.
- The ACO has been given the authority to investigate potential activities of politically exposed persons that have been linked to illicit enrichment and/or proceeds of money laundering.
- New procurement standards have included electronic procurement, formalization of procedures for costing out projects, and transparent processes to renegotiate debts to suppliers. OECD guidelines on corporate governance for state-owned enterprises were adopted to promote transparency and accountability during the procurement process. The authorities estimate that improvements in procurement have saved approximately US$1.9 billion for the year ended 2016, and year-to-date savings for 2017 are US$1.5 billion.

STAFF APPRAISAL

37. Argentina's economy is recovering. Investment has accelerated while a brisk rise in real wages and credit growth has supported consumption. Stronger domestic demand has moved the trade balance from surplus to deficit and increased the current account deficit. The large general government deficit has led to a rapid rise in foreign currency borrowing and raised future gross external financing needs. A slower-than-targeted decline in inflation and significant foreign inflows have put upward pressure on the real exchange rate leaving the peso overvalued by 10–25 percent and the external position moderately weaker than the level implied by medium-term fundamentals and desirable policies.

38. There are important imbalances in the policy mix. Lower energy subsidies and one-off revenues from the tax amnesty have allowed personal income taxes and export taxes to be reduced. However, the high primary deficit and rising interest costs have led to a larger fiscal deficit, increasing public debt. In addition, part of the federal fiscal financing needs continues to be met by central bank monetary transfers, potentially weakening the credibility of the central bank's inflation targeting framework. With little support from fiscal policy, the central bank has had to maintain relatively high real interest rates and, even then, inflation has exceeded the targeted path of disinflation. In sum, the current policy mix has contributed to an overvalued currency, a slow pace of disinflation, higher public debt, and vulnerabilities associated with growing gross external financing needs.

39. A front-loaded reduction in public spending and a lower fiscal deficit would reduce external vulnerabilities, build credibility, and help anchor inflation expectations. The authorities' consolidation plan goes in the right direction but a larger, and more frontloaded fiscal adjustment—one that reduces the federal primary deficit by 3–4 percent of GDP by 2019—would allow for lower interest rates; reduce upward pressures on the peso; facilitate a faster elimination of monetary financing of the fiscal deficit; better anchor inflation expectations; create a more sustainable path for the public debt; and reduce vulnerabilities to a sudden tightening of external financing conditions. To be clear: what is needed is a recalibration in the policy *mix*, with a greater reliance on fiscal tools, *not* an overall tightening in policy.

40. Lower government spending is essential. Spending reductions should focus on areas where expenditure has increased very rapidly over the past several years, notably wages, pensions, and social transfer. With one third of the population living below the poverty threshold, it would be important to mitigate the impact of the fiscal rebalancing on the poor. While the new Fiscal Pact with provinces encourages fiscal discipline at subnational level, further strengthening the institutional framework for fiscal policy will lessen the economic costs associated with realigning the fiscal position. The authorities' commitment to improve integrity and transparency and fight corruption should be commended, and has already resulted in important efficiency gains and budgetary cost savings.

41. The authorities' proposed tax reform is a good step forward to overhaul Argentina's inefficient tax system. However, more could be done to shift the tax burden away from labor and eliminate distortionary taxes. Caution is warranted in relying on unpredictable growth effects to offset the revenue losses from tax reform. Instead, lower public spending will be needed to cover the cost of the tax reform while still lowering the deficit.

42. Boosting productivity and growth will require removing trade and investment barriers and continue developing local capital markets. The authorities should be commended for removing FX controls and trade restrictions that severely limited Argentina's integration into the global economy, and for recent initiatives to reduce red tape. Nevertheless, a more accelerated reduction in import tariffs and the elimination of most import licenses is warranted. Changes are also needed to boost domestic competition, including removing barriers to trade, investment, and firm entry as well as addressing anti-competitive business practices. There is a pressing need to continue developing the financial system and increase financial inclusion while strengthening oversight and protecting financial stability.

43. Institutional changes are needed to reduce informality, address gender discrimination, and ensure the benefits from higher growth are shared more equally. Creating quality jobs for all Argentinean is the most effective and sustainable way to reduce poverty, raise output, increase productivity, and provide opportunities. Argentina's labor market is far from being inclusive. Women, the less-educated, and the young participate in the labor force at lower rates and are more likely to work in the informal sector. Lowering the marginal tax rate on labor income—particularly for lower-income workers, as in the authorities' proposed tax reform, and for second earners—would encourage formality and reduce gender-bias. Allowing for more flexible work arrangements and providing childcare support would also facilitate access to employment for working families. Finally, active labor market policies, such as training and job search assistance, can help increase the employability of all workers, particularly if they are designed to support women, the young, and lower-income workers.

44. Staff proposes that the next Article IV consultation takes place on the standard 12-month cycle.

Table 1. Risk Assessment Matrix 1/

Source of Risks	Relative Likelihood	Expected Impact	Policy Response
Downside Risks			
Tighter and more volatile global financial conditions	High	**High** Premature normalization of monetary policy conditions could spur a reassessment of global risk leading to an increase of sovereign and corporate risk premia, portfolio rebalancing, and lower capital flows to EMs. This would limit availability of funding of Argentina's fiscal needs through external bond issuances and repatriation of funds by non-bank domestic private sector. Domestic financial sector's funding could increase, but given its small size it would not be able to meet the gross financing needs of the federal and provincial government.	Tighter global financial conditions and limited capital inflows would require a more accelerated reduction of the fiscal deficit.
Higher and more persistent inflation	Medium	**Medium** Upward pressures on inflation emerge because of higher wage growth and/or higher persistence in inflation and/or stronger second round effects from increase in tariffs. The currency could become more overvalued, and expectations of a future depreciation might increase, which would fuel inflation expectations and lower the demand for the peso.	Facing a wage-price spiral and the risk of a run on the peso, the central bank should react by increasing interest rates. A faster reduction of the fiscal deficit may also be needed to immediately reduce inflationary pressures.
A sudden depreciation of the currency	Medium	**High** Continued appreciation of the currency leads to a worsening of the current peso misalignment, a deterioration of the external position, and renewed bouts of balance of payments pressures. A sharp devaluation of the currency realigns the currency and alleviates the pressures, leading to a jump in inflation and an immediate contraction of economic activity with high social costs, as household's purchasing power is reduced. High FX exposure of the public sector can lead to a greater public sector debt and financing difficulties.	The central bank would need to increase interest rates to defend the peso, while fiscal policy could be tightened (taking measures to protect the most vulnerable segments of society, for example, though a faster elimination of energy subsidies, reducing the most regressive forms of tax expenditure, and expanding the PIT base, using the resources to fund means-tested transfers).
Significant China slowdown	Low (in the short run)	**Medium** Weaker activity in China would impact Argentina primarily through trade channels, including through a negative impact on the terms of trade, as commodity prices would fall. This would affect especially soy sector, as about 3/4 of Argentina's soybean exports is destined to China. Staff estimates suggest that a 1 percentage point decrease in China's growth would lower Argentina's export growth by 0.4–0.7 percentage points. Slower growth in China would also affect Argentina indirectly, through its negative impact on the region, particularly on Brazil.	· The depreciation of the peso would help the economy adjust to the terms of trade shock. · If needed, monetary and fiscal policy stances could be relaxed (fiscal policy could be re-oriented to protect the most vulnerable segments of society). · The authorities could accelerate structural reforms to increase export competitiveness and diversification.
Upside Risks			
Stronger rebound of growth due to faster pace of reforms	Medium	**High** An aggressive implementation of labor, tax and product market reforms could boost Argentina potential growth. Staff estimates show that tax, product, and labor market reforms that would allow Argentina to close half of its gap with the average of EMs in a 10-year time horizon would increase potential GDP growth by about 1½ percentage points.	The authorities could take advantage of the stronger GDP path to accelerate the pace of reduction of the fiscal deficit.
Stronger recovery in Brazil	Medium	**High** A stronger recovery of Brazil would have important positive spillover effects on Argentina's economy. The Brazilian market is especially relevant for Argentine industrial exports. More than 45 percent of exports of industrial manufactures go to Brazil. Staff estimates suggest that a 1 percentage point increase in Brazil's growth would boost Argentina's export growth by 0.7 percentage points, and has a peak impact of ¼ percent on Argentina's growth.	The authorities could take advantage of the stronger GDP path to accelerate the pace of reduction of the fiscal deficit and to implement supply-side reforms, especially those that entail short-term costs, like removing current protections to specific sectors of the economy.

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

Table 2. Argentina: Selected Economic and Financial Indicators

	Average 2009–14	2015	2016	Proj. 2017	2018	2019	2020	2021	2022
National income, prices, and labor markets									
GDP at constant prices	1.5	2.6	-2.2	2.8	2.5	2.8	3.1	3.1	3.2
Domestic demand	2.6	4.0	-1.5	5.4	3.7	3.2	3.4	3.3	3.4
Consumption	2.8	4.0	-1.2	4.5	2.6	2.7	2.8	2.8	3.2
Private	2.6	3.5	-1.4	5.1	3.3	3.4	3.4	3.4	3.6
Public	4.5	6.8	0.3	1.3	-1.3	-1.5	-0.7	-0.8	0.6
Investment	1.6	3.8	-5.1	13.1	9.3	5.0	5.4	5.2	4.1
Private	1.0	4.4	-6.3	16.4	14.3	6.1	5.2	4.9	4.2
Public	5.0	3.9	-1.2	2.2	-9.1	-0.1	6.5	6.8	3.7
Exports	-1.0	-0.6	3.7	1.7	8.0	6.2	5.7	5.3	5.0
Imports	4.4	5.7	5.7	12.3	10.7	6.4	5.9	5.4	4.8
Change in inventories and stat. disc. (contribution to growth)	0.1	0.0	0.5	-0.6	-0.2	0.0	0.0	0.0	0.0
Nominal GDP (billions of Argentine pesos)	2,609	5,854	8,050	10,326	12,735	14,877	16,986	19,199	21,617
Output gap (percent)	…	1.2	-2.1	-1.5	-1.6	-1.4	-1.2	-1.0	-0.7
CPI inflation (eop, y/y percent change)	…	…	…	23.6	16.3	11.8	10.0	9.3	8.6
Unemployment rate (percent)	7.5	…	8.5	8.1	7.7	7.2	6.8	6.4	6.1
External sector									
Exports f.o.b. (goods, billions of U.S. dollars)	71.9	56.8	57.8	58.5	63.5	67.8	71.9	76.2	80.2
Imports f.o.b. (goods, billions of U.S. dollars)	60.1	57.2	53.2	63.3	68.8	74.2	79.5	84.9	89.1
Trade balance (goods, billions of U.S. dollars)	11.8	-0.4	4.5	-4.8	-5.3	-6.4	-7.6	-8.6	-8.9
Trade balance (goods)	2.6	-0.1	0.8	-0.8	-0.8	-0.9	-1.0	-1.0	-1.0
Terms of trade (percent change)	1.6	-4.0	6.1	-4.7	-1.0	-0.6	-0.7	-0.8	-0.3
Total external debt	34.7	28.3	36.1	36.2	38.8	39.9	42.4	45.1	47.8
Savings-Investment balance									
Gross domestic investment	16.3	15.8	14.8	16.3	17.3	17.5	17.8	18.1	18.2
Gross national savings	15.7	13.1	12.2	12.0	12.9	13.1	13.3	13.5	13.5
Current account balance	-0.5	-2.7	-2.7	-4.3	-4.4	-4.4	-4.5	-4.6	-4.7
Public sector 1/									
Primary balance	-1.9	-4.7	-4.8	-4.7	-3.7	-2.5	-1.9	-1.9	-1.7
of which: Federal government	-3.4	-4.1	-4.3	-4.2	-3.2	-2.2	-2.0	-1.9	-1.8
memo: Structural federal primary balance 2/	-1.4	-4.7	-4.5	-4.3	-2.8	-1.9	-1.8	-1.7	-1.7
Overall balance	-2.9	-5.9	-6.5	-6.9	-6.0	-5.0	-4.5	-4.9	-5.2
of which: Federal government	-2.4	-5.2	-5.9	-6.3	-5.5	-4.7	-4.5	-4.9	-5.3
Revenues	31.6	35.7	35.7	34.8	34.0	34.0	34.0	33.7	33.7
Primary expenditure 3/	34.9	40.5	40.4	39.5	37.7	36.5	35.9	35.6	35.5
Total public debt (federal)	42.9	56.0	54.2	52.8	51.7	50.6	50.5	51.4	52.7
Money and credit									
Monetary base (eop, y/y percent change)	27.5	34.9	31.7	21.2	17.4	14.6	13.4	12.6	12.0
M2 (percent change)	28.7	28.2	30.4	22.6	19.0	15.3	14.1	12.9	12.0
Credit to the private sector (eop, y/y percent change)	28.9	35.7	31.2	39.4	22.8	17.4	15.4	14.4	13.2
Credit to the private sector real (eop, y/y percent change)	…	…	…	12.8	5.6	5.0	4.9	4.7	4.2
Interest rate (eop) 4/	16.3	32.2	23.9	27.8	20.3	16.2	14.7	14.1	14.2
Real interest rate (eop) 4/	…	…	…	9.9	7.6	5.6	4.9	5.0	5.1
Memorandum items									
Gross international reserves (billions of U.S. dollars)	42.0	25.6	39.3	50.7	56.2	57.5	60.9	65.2	69.3
Exchange rate (eop, Arg$/US$)	5.3	13.0	15.9	…	…	…	…	…	…
Change in REER (eop, percent change)	8.4	5.3	-3.4	3.2	2.8	2.2	1.3	0.8	0.5

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

1/ The primary balance excludes profit transfers from the central bank of Argentina. Interest expenditure is net of property income from the social security fund before 2016.

2/ Percent of potential GDP.

3/ Includes transfers to municipalities, but excludes municipal spending.

4/ Average of all LEBAC maturities before 2017 and midpoint of the repo corridor starting in 2017; ex ante real rates.

Table 3. Argentina: Summary Balance of Payments, 2011–22

							Proj.					
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
						(Billions of U.S. dollars)						
Current account	**-5.3**	**-2.1**	**-13.1**	**-8.7**	**-17.2**	**-14.5**	**-26.9**	**-28.4**	**-31.5**	**-34.7**	**-38.0**	**-40.8**
Trade balance in goods	12.4	15.0	4.6	6.0	-0.4	4.5	-4.8	-5.3	-6.4	-7.6	-8.6	-8.9
Exports f.o.b.	83.1	80.1	75.9	68.4	56.8	57.8	58.5	63.5	67.8	71.9	76.2	80.2
Primary products	20.2	19.2	18.7	14.8	13.3	15.7	14.2	15.6	17.0	18.5	20.1	21.7
Manufactures of agricultural origin	28.2	27.7	29.0	27.9	23.3	23.3	23.5	24.8	26.1	27.5	28.8	30.1
Manufactures of industrial origin	28.1	26.4	22.6	20.8	18.0	16.7	19.1	21.2	22.7	24.0	25.4	26.5
Energy	6.6	6.9	5.6	4.9	2.2	2.0	2.1	1.9	1.9	1.9	2.0	2.0
Imports f.o.b.	70.8	65.0	71.3	62.4	57.2	53.2	63.3	68.8	74.2	79.5	84.9	89.1
Capital goods (includes parts and accessories)	27.6	25.1	26.9	23.7	23.4	22.4	26.5	29.2	31.9	34.5	37.2	39.3
Intermediate goods	20.9	19.1	18.7	17.9	17.3	14.8	17.1	18.9	20.4	22.0	23.6	24.8
Consumer goods	13.0	11.9	14.7	9.5	10.1	11.3	14.2	14.6	15.5	16.3	17.1	17.9
Fuels and lubricants	9.2	8.9	11.0	11.3	6.4	4.7	5.5	6.2	6.4	6.7	6.9	7.2
Trade balance in services	-3.2	-4.1	-5.3	-4.6	-5.8	-8.1	-9.5	-10.1	-11.2	-12.1	-12.9	-13.8
Exports	14.5	14.2	13.7	13.4	13.2	12.8	14.6	15.9	18.1	20.0	21.9	24.0
Imports	17.6	18.3	19.0	18.0	19.0	21.0	24.2	26.0	29.3	32.1	34.8	37.8
Primary income, net	-15.1	-13.8	-13.2	-11.6	-12.1	-12.1	-13.6	-14.1	-15.0	-16.1	-17.5	-19.2
Secondary income, net	0.5	0.7	0.7	1.5	1.1	1.2	1.1	1.1	1.1	1.1	1.1	1.1
Capital Account	**0.1**	**0.0**	**0.0**	**0.1**	**0.1**	**0.4**	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**
Financial Account	**10.0**	**8.6**	**16.1**	**9.0**	**18.4**	**14.9**	**26.4**	**28.4**	**31.2**	**34.5**	**37.7**	**40.6**
Foreign direct investment, net	9.4	14.3	8.9	3.1	10.9	1.5	4.9	5.9	9.0	12.2	15.2	17.5
Portfolio investment, net	0.1	-0.2	0.4	-2.3	0.4	35.3	38.8	28.6	25.9	28.5	31.3	33.8
Derivatives, net	2.4	2.9	0.0	-0.2	0.0	0.2	-0.1	0.0	0.0	0.0	0.0	0.0
Other investment, net	-8.0	-11.7	-5.1	9.5	2.2	-7.7	-6.3	-0.7	-2.3	-2.8	-4.3	-6.7
Reserve assets	6.1	3.3	11.8	-1.2	4.9	-14.3	-10.8	-5.4	-1.3	-3.4	-4.4	-4.1
Errors and Omissions	**0.0**	**-0.7**	**-3.1**	**-0.7**	**-1.4**	**-0.3**	**0.3**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Overall balance	**4.7**	**5.8**	**-0.1**	**-0.3**	**0.0**	**0.4**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Current account	**-1.0**	**-0.4**	**-2.1**	**-1.5**	**-2.7**	**-2.7**	**-4.3**	**-4.4**	**-4.4**	**-4.5**	**-4.6**	**-4.7**
Trade balance in goods	2.3	2.6	0.8	1.1	-0.1	0.8	-0.8	-0.8	-0.9	-1.0	-1.0	-1.0
Exports, f.o.b.	15.8	13.8	12.4	12.1	9.0	10.6	9.4	9.7	9.4	9.3	9.3	9.2
Imports f.o.b.	-13.4	-11.2	-11.7	-11.1	-9.1	-9.8	-10.2	-10.6	-10.3	-10.3	-10.3	-10.2
Trade balance in services	-0.6	-0.7	-0.9	-0.8	-0.9	-1.5	-1.5	-1.5	-1.6	-1.6	-1.6	-1.6
Exports	2.7	2.5	2.2	2.4	2.1	2.4	2.4	2.4	2.5	2.6	2.7	2.7
Imports	-3.3	-3.2	-3.1	-3.2	-3.0	-3.8	-3.9	-4.0	-4.1	-4.1	-4.2	-4.3
Primary income, net	-2.9	-2.4	-2.2	-2.1	-1.9	-2.2	-2.2	-2.2	-2.1	-2.1	-2.1	-2.2
Secondary income, net	0.1	0.1	0.1	0.3	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1
Capital Account	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Financial Account	1.9	1.5	2.6	1.6	2.9	2.7	4.2	4.4	4.3	4.4	4.6	4.6
Foreign direct investment, net	1.8	2.5	1.5	0.6	1.7	0.3	0.8	0.9	1.2	1.6	1.8	2.0
Portfolio investment, net	0.0	0.0	0.1	-0.4	0.1	6.5	6.2	4.4	3.6	3.7	3.8	3.9
Derivatives, net	0.4	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment, net	-1.5	-2.0	-0.8	1.7	0.4	-1.4	-1.0	-0.1	-0.3	-0.4	-0.5	-0.8
Reserve assets	1.1	0.5	2.1	-0.1	0.9	-2.5	-1.8	-0.8	-0.2	-0.4	-0.5	-0.5
Memorandum items:												
Exports volumes (percent change)	2.3	-5.8	-3.7	-7.8	-1.7	6.6	-0.1	7.7	6.3	5.6	5.4	4.9
Imports volumes (percent change)	21.6	-6.0	3.5	-12.0	3.1	4.2	11.0	7.2	6.6	6.0	5.3	4.5
Gross international reserves (in billions of US$)	46.4	43.3	30.6	31.4	25.6	39.3	50.7	56.2	57.5	60.9	65.2	69.3
(in months of imports of goods and services)	6.3	6.2	4.1	4.7	4.0	6.4	7.0	7.1	6.7	6.5	6.5	6.6
Terms of Trade (Index, 2000 = 100)	555.2	578.7	541.0	526.4	505.4	536.3	511.3	506.3	503.1	499.7	495.8	494.3
Real effective exchange rate (percent change)	13.0	17.2	-2.6	6.9	5.3	-3.4	3.2	2.8	2.2	1.3	0.8	0.5

Sources: INDEC, Fund staff estimates and projections.

Table 4. Argentina: Consolidated Public Sector Operations, 2011–22 1/

	2011	2012	2013	2014	2015	2016	Proj. 2017	2018	2019	2020	2021	2022
						(Billions of Argentine pesos)						
Revenues	**700.7**	**891.0**	**1,150.1**	**1,562.9**	**2,091.8**	**2,871.6**	**3,590.1**	**4,335.0**	**5,063.2**	**5,775.2**	**6,478.1**	**7,289.5**
Tax revenues	485.2	612.9	792.1	1,074.2	1,429.9	1,952.8	2,430.7	2,926.2	3,410.0	3,891.1	4,367.7	4,913.3
Social security contributions	167.8	219.5	287.8	378.3	529.5	709.8	913.1	1,113.8	1,308.6	1,490.6	1,684.9	1,897.1
Other revenues	47.7	58.6	70.2	110.4	132.4	209.0	246.2	295.0	344.6	393.4	425.5	479.1
Primary Expenditures 1/	**735.3**	**936.4**	**1,238.5**	**1,723.1**	**2,368.9**	**3,255.5**	**4,078.6**	**4,807.5**	**5,429.3**	**6,104.5**	**6,837.2**	**7,663.6**
Wages	227.6	294.4	378.2	523.7	738.7	1,008.4	1,296.6	1,574.3	1,812.5	2,037.7	2,269.7	2,547.2
Goods and services	53.3	64.3	86.3	120.3	169.7	205.8	257.5	295.7	328.5	361.6	396.2	431.4
Transfers to the private sector	277.2	356.0	466.1	663.0	932.0	1,343.3	1,642.7	1,932.7	2,151.1	2,408.7	2,699.9	3,043.1
Of which: federal pensions	147.1	204.6	272.1	363.4	535.7	734.7	1,000.9	1,273.6	1,495.3	1,729.3	1,969.9	2,221.9
Capital spending	77.7	83.2	121.0	171.6	216.6	280.1	357.2	388.6	436.8	512.8	598.9	674.3
Other	99.4	138.5	186.9	244.5	311.9	418.0	524.6	616.2	700.3	783.7	872.5	967.6
Primary balance	**-34.6**	**-45.4**	**-88.3**	**-160.2**	**-277.1**	**-383.9**	**-488.5**	**-472.5**	**-366.1**	**-329.3**	**-359.1**	**-374.1**
Interest cash	25.2	34.9	20.6	34.5	70.6	136.7	223.4	297.0	380.2	439.7	582.0	752.9
Overall balance	**-59.8**	**-80.3**	**-108.9**	**-194.7**	**-347.7**	**-520.6**	**-712.0**	**-769.5**	**-746.3**	**-769.1**	**-941.1**	**-1,126.9**
						(Percent of GDP unless otherwise indicated)						
Revenues	**32.2**	**33.8**	**34.3**	**34.1**	**35.7**	**35.7**	**34.8**	**34.0**	**34.0**	**34.0**	**33.7**	**33.7**
Tax revenues	22.3	23.2	23.7	23.5	24.4	24.3	23.5	23.0	22.9	22.9	22.7	22.7
Social security contributions	7.7	8.3	8.6	8.3	9.0	8.8	8.8	8.7	8.8	8.8	8.8	8.8
Other revenues	2.2	2.2	2.1	2.4	2.3	2.6	2.4	2.3	2.3	2.3	2.2	2.2
Primary expenditures 1/	**33.7**	**35.5**	**37.0**	**37.6**	**40.5**	**40.4**	**39.5**	**37.7**	**36.5**	**35.9**	**35.6**	**35.5**
Wages	10.4	11.2	11.3	11.4	12.6	12.5	12.6	12.4	12.2	12.0	11.8	11.8
Goods and services	2.4	2.4	2.6	2.6	2.9	2.6	2.5	2.3	2.2	2.1	2.1	2.0
Transfers to the private sector	12.7	13.5	13.9	14.5	15.9	16.7	15.9	15.2	14.5	14.2	14.1	14.1
Of which: federal pensions	6.8	7.8	8.1	7.9	9.2	9.1	9.7	10.0	10.1	10.2	10.3	10.3
Capital spending	3.6	3.2	3.6	3.7	3.7	3.5	3.5	3.1	2.9	3.0	3.1	3.1
Other	4.6	5.3	5.6	5.3	5.3	5.2	5.1	4.8	4.7	4.6	4.5	4.5
Primary balance	**-1.6**	**-1.7**	**-2.6**	**-3.5**	**-4.7**	**-4.8**	**-4.7**	**-3.7**	**-2.5**	**-1.9**	**-1.9**	**-1.7**
Interest cash	1.2	1.3	0.6	0.8	1.2	1.7	2.2	2.3	2.6	2.6	3.0	3.5
Overall balance	**-2.7**	**-3.0**	**-3.3**	**-4.3**	**-5.9**	**-6.5**	**-6.9**	**-6.0**	**-5.0**	**-4.5**	**-4.9**	**-5.2**
Structural primary balance (General Government) 2/	**-2.7**	**-2.4**	**-3.6**	**-3.5**	**-5.4**	**-4.8**	**-4.7**	**-3.2**	**-2.1**	**-1.6**	**-1.6**	**-1.5**
Structural primary balance (Federal) 2/	**-1.5**	**-1.8**	**-3.1**	**-3.5**	**-4.7**	**-4.5**	**-4.3**	**-2.8**	**-1.9**	**-1.8**	**-1.7**	**-1.7**
Structural primary balance (Provinces) 2/	**-1.1**	**-0.6**	**-0.5**	**0.0**	**-0.8**	**-0.3**	**-0.4**	**-0.4**	**-0.1**	**0.2**	**0.2**	**0.2**

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

1/ Include transfers to municipalities, but exclude municipal spending.

2/ Percent of potential GDP.

Table 5. Argentina: Federal Government Operations, 2015–22

	2015	2016	2017	2018	2019	2020	2021	2022
			Proj.					
	(Billions of Argentine pesos)							
Revenues	**1,595.0**	**2,180.9**	**2,731.2**	**3,325.9**	**3,869.6**	**4,395.4**	**4,956.9**	**5,576.8**
Tax revenues	1,115.2	1,528.3	1,872.2	2,264.0	2,621.6	2,974.0	3,350.3	3,767.8
Social security contributions	419.4	558.1	717.8	887.8	1,044.5	1,189.1	1,344.1	1,513.4
Nontax revenues	60.3	94.6	141.2	174.2	203.4	232.3	262.5	295.6
Primary expenditures	**1,834.4**	**2,524.5**	**3,160.3**	**3,732.4**	**4,195.7**	**4,737.7**	**5,329.6**	**5,976.1**
Federal expenditures	1,331.2	1,835.0	2,258.4	2,639.4	2,939.5	3,310.7	3,701.8	4,140.9
Wages	236.8	316.8	407.4	490.2	566.4	639.8	717.1	799.3
Goods and services	78.9	91.8	115.8	137.1	154.0	170.4	186.7	203.3
Pensions	535.7	734.7	1,000.9	1,273.6	1,495.3	1,729.3	1,969.9	2,221.9
Current transfers to private sector	322.4	511.0	516.6	513.6	500.7	519.3	558.7	628.3
Social assistance	143.3	219.9	273.4	337.1	399.7	460.9	523.5	588.7
Energy	138.0	209.2	147.0	100.4	34.4	34.8	26.1	32.3
Transport	51.1	80.2	90.0	68.5	59.3	16.3	1.8	0.0
Other	-10.1	1.7	6.2	7.6	7.3	7.3	7.3	7.3
Capital spending	91.7	117.8	138.7	142.0	148.8	184.0	208.0	234.1
Other current primary spending	65.7	62.8	79.0	82.9	74.4	67.9	61.4	54.0
Transfers to provinces	503.2	689.5	901.9	1,093.0	1,256.2	1,426.9	1,627.8	1,835.2
Automatic	406.4	551.6	731.7	921.1	1,083.6	1,248.6	1,416.6	1,608.2
Discretionary	96.8	137.8	170.2	171.9	172.6	178.3	211.2	227.0
Capital	69.2	64.3	87.6	110.8	113.1	122.3	153.6	172.9
Current	27.6	73.6	82.6	61.1	59.5	56.1	57.6	54.0
Primary balance	**-239.5**	**-343.5**	**-429.2**	**-406.5**	**-326.2**	**-342.2**	**-372.6**	**-399.3**
Interest cash (net ANSES)	67.4	131.3	216.5	289.8	371.3	429.4	570.8	740.1
Overall balance	**-306.9**	**-474.8**	**-645.7**	**-696.3**	**-697.4**	**-771.7**	**-943.5**	**-1,139.5**
Memorandum items:								
Capital spending, including capital transfers to provinces	160.9	182.0	226.3	252.8	261.8	306.3	361.5	407.1
Arrears and advances	0.0	-33.0	16.0	0.0	0.0	0.0	0.0	0.0
Primary balance, accrual basis	-239.5	-310.5	-445.2	-406.5	-326.2	-342.2	-372.6	-399.3
Overall balance, accrual basis	-306.9	-441.8	-661.7	-696.3	-697.4	-771.7	-943.5	-1,139.5
Structural primary balance	-269.0	-371.7	-452.4	-368.0	-288.7	-306.3	-337.1	-370.5
	(Percent of GDP)							
Revenues	**27.2**	**27.1**	**26.4**	**26.1**	**26.0**	**25.9**	**25.8**	**25.8**
Tax revenues	19.1	19.0	18.1	17.8	17.6	17.5	17.5	17.4
Social security contributions	7.2	6.9	7.0	7.0	7.0	7.0	7.0	7.0
Nontax revenues	1.0	1.2	1.4	1.4	1.4	1.4	1.4	1.4
Primary expenditures	**31.3**	**31.4**	**30.6**	**29.3**	**28.2**	**27.9**	**27.8**	**27.6**
Federal expenditures	22.7	22.8	21.9	20.7	19.8	19.5	19.3	19.2
Wages	4.0	3.9	3.9	3.8	3.8	3.8	3.7	3.7
Goods and services	1.3	1.1	1.1	1.1	1.0	1.0	1.0	0.9
Pensions	9.2	9.1	9.7	10.0	10.1	10.2	10.3	10.3
Current transfers to private sector	5.5	6.3	5.0	4.0	3.4	3.1	2.9	2.9
Social assistance	2.4	2.7	2.6	2.6	2.7	2.7	2.7	2.7
Energy	2.4	2.6	1.4	0.8	0.2	0.2	0.1	0.1
Transport	0.9	1.0	0.9	0.5	0.4	0.1	0.0	0.0
Other	-0.2	0.0	0.1	0.1	0.0	0.0	0.0	0.0
Capital spending	1.6	1.5	1.3	1.1	1.0	1.1	1.1	1.1
Other current primary spending	1.1	0.8	0.8	0.7	0.5	0.4	0.3	0.3
Transfers to provinces	8.6	8.6	8.7	8.6	8.4	8.4	8.5	8.5
Automatic	6.9	6.9	7.1	7.2	7.3	7.4	7.4	7.4
Discretionary	1.7	1.7	1.6	1.4	1.2	1.1	1.1	1.1
Capital	1.2	0.8	0.8	0.9	0.8	0.7	0.8	0.8
Current	0.5	0.9	0.8	0.5	0.4	0.3	0.3	0.3
Primary balance	**-4.1**	**-4.3**	**-4.2**	**-3.2**	**-2.2**	**-2.0**	**-1.9**	**-1.8**
Interest cash (net ANSES)	1.2	1.6	2.1	2.3	2.5	2.5	3.0	3.4
Overall balance	**-5.2**	**-5.9**	**-6.3**	**-5.5**	**-4.7**	**-4.5**	**-4.9**	**-5.3**
Memorandum items:								
Capital spending, including capital transfers to provinces	2.7	2.3	2.2	2.0	1.8	1.8	1.9	1.9
Arrears and advances	0.0	-0.4	0.2	0.0	0.0	0.0	0.0	0.0
Primary balance, accrual basis	-4.1	-3.9	-4.3	-3.2	-2.2	-2.0	-1.9	-1.8
Overall balance, accrual basis	-5.2	-5.5	-6.4	-5.5	-4.7	-4.5	-4.9	-5.3
Structural primary balance 1/	-4.7	-4.5	-4.3	-2.8	-1.9	-1.8	-1.7	-1.7

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

1/ Percent of potential GDP.

Table 6. Argentina: Summary Operations of the Financial System, 2011–22

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

	2011	2012	2013	2014	2015	2016	Proj. 2017	2018	2019	2020	2021	2022
							I. Central Bank					
Net foreign assets	172.9	193.0	183.5	219.0	157.5	430.2	689.1	867.9	956.6	1,093.6	1,263.8	1,447.3
Net domestic assets	50.0	114.2	193.7	243.5	466.4	391.5	306.5	301.0	383.2	426.3	447.5	469.0
Credit to the public sector (net)	191.5	311.7	472.2	697.7	1,194.4	1,459.9	1,698.7	1,966.4	2,071.3	2,187.2	2,295.7	2,394.3
Credit to the financial sector (net)	-93.6	-122.0	-154.1	-279.6	-401.7	-589.4	-615.4	-818.0	-912.2	-999.6	-1,084.6	-1,149.6
Official capital and other items (net)	-47.9	-75.5	-124.4	-174.6	-326.3	-479.1	-776.9	-847.4	-775.9	-761.3	-763.6	-775.7
Monetary base	222.9	307.2	377.2	462.6	623.9	821.7	995.6	1,168.9	1,339.9	1,519.9	1,711.3	1,916.3
Currency issued	173.1	237.0	289.2	358.8	478.8	594.6	720.5	845.9	969.6	1,099.9	1,238.4	1,386.7
Bank deposits at the Central Bank	49.9	70.2	88.0	103.8	145.1	227.0	275.1	323.0	370.2	420.0	472.9	529.5
							II. Consolidated Financial System					
Net foreign assets	168.3	195.9	182.5	218.6	155.9	463.3	685.2	868.6	962.0	1,103.9	1,279.3	1,468.5
Net domestic assets	308.6	439.7	620.1	815.3	1,330.7	1,580.0	1,895.7	2,246.1	2,663.2	3,049.0	3,449.6	3,866.7
Credit to the public sector (net)	134.1	227.5	370.9	571.5	1,110.2	1,361.5	1,608.2	1,817.8	1,898.2	1,993.1	2,097.6	2,225.7
Credit to the private sector	305.3	401.3	526.7	633.0	858.3	1,124.6	1,569.7	1,927.3	2,263.5	2,612.0	2,988.7	3,383.3
Net capital, reserves, and other assets	-130.7	-189.1	-277.5	-389.2	-637.8	-906.1	-1,282.2	-1,499.0	-1,498.5	-1,556.1	-1,636.7	-1,742.3
Liabilities with the private sector	477.1	635.5	802.3	1,033.7	1,484.7	2,042.8	2,580.9	3,114.7	3,625.1	4,152.8	4,728.9	5,347.1
Currency outside banks	151.2	209.9	257.7	315.8	425.5	527.6	650.3	763.6	875.3	992.8	1,117.9	1,251.8
Local currency deposits	273.4	386.3	499.4	653.8	920.4	1,158.5	1,466.7	1,774.9	2,055.3	2,328.4	2,617.6	2,905.0
Foreign currency deposits	52.4	39.2	45.1	64.1	138.7	356.6	463.8	576.2	694.5	831.5	993.4	1,190.4
							I. Central Bank (Percent of GDP)					
Net foreign assets	7.9	7.3	5.5	4.8	2.7	5.3	6.7	6.8	6.4	6.4	6.6	6.7
Net domestic assets	2.3	4.3	5.8	5.3	8.0	4.9	3.0	2.4	2.6	2.5	2.3	2.2
Credit to the public sector (net)	8.8	11.8	14.1	15.2	20.4	18.1	16.5	15.4	13.9	12.9	12.0	11.1
Credit to the private sector	-4.3	-4.6	-4.6	-6.1	-6.9	-7.3	-6.0	-6.4	-6.1	-5.9	-5.6	-5.3
Official capital and other items (net)	-2.2	-2.9	-3.7	-3.8	-5.6	-6.0	-7.5	-6.7	-5.2	-4.5	-4.0	-3.6
Monetary base	10.2	11.6	11.3	10.1	10.7	10.2	9.6	9.2	9.0	8.9	8.9	8.9
Currency issued	7.9	9.0	8.6	7.8	8.2	7.4	7.0	6.6	6.5	6.5	6.5	6.4
Bank deposits at the central bank	2.3	2.7	2.6	2.3	2.5	2.8	2.7	2.5	2.5	2.5	2.5	2.4
							II. Consolidated Financial System (Percent of GDP)					
Net foreign assets	7.7	7.4	5.5	4.8	2.7	5.8	6.6	6.8	6.5	6.5	6.7	6.8
Net domestic assets	14.2	16.7	18.5	17.8	22.7	19.6	18.4	17.6	17.9	18.0	18.0	17.9
Credit to the public sector (net)	6.2	8.6	11.1	12.5	19.0	16.9	15.6	14.3	12.8	11.7	10.9	10.3
Credit to the private sector	14.0	15.2	15.7	13.8	14.7	14.0	15.2	15.1	15.2	15.4	15.6	15.7
Net capital, reserves, and other assets	-6.0	-7.2	-8.3	-8.5	-10.9	-11.3	-12.4	-11.8	-10.1	-9.2	-8.5	-8.1
Liabilities with the private sector	21.9	24.1	24.0	22.6	25.4	25.4	25.0	24.5	24.4	24.4	24.6	24.7
Currency outside banks	6.9	8.0	7.7	6.9	7.3	6.6	6.3	6.0	5.9	5.8	5.8	5.8
Local currency deposits	12.5	14.6	14.9	14.3	15.7	14.4	14.2	13.9	13.8	13.7	13.6	13.4
Foreign currency deposits	2.4	1.5	1.3	1.4	2.4	4.4	4.5	4.5	4.7	4.9	5.2	5.5
							Changes in monetary base (y/y, in AR$ billion)					
Monetary base	62.5	84.4	69.8	85.4	161.3	197.8	173.9	173.4	171.0	180.0	191.4	205.0
Foreign exchange purchases	9.6	27.2	-16.4	81.9	-69.5	209.1	214.8	103.4	28.0	73.6	100.2	98.3
Public sector	36.3	61.3	78.1	128.1	175.7	151.2	143.2	140.0	110.0	80.0	50.0	25.0
Sterilization, net (-)	16.2	-5.6	7.2	-121.4	-2.4	-176.6	-181.2	-70.0	32.9	26.3	41.2	81.6
Other items, net	-2.2	-1.5	0.9	-3.1	57.5	14.0	-2.9	0.0	0.0	0.0	0.0	0.0
Memorandum items:												
M2 1/	366.1	506.5	637.0	821.1	1,052.6	1,372.3	1,682.5	2,002.4	2,308.6	2,633.9	2,974.2	3,330.5
M2 (percent change) 1/	29.9	38.3	25.8	28.9	28.2	30.4	22.6	19.0	15.3	14.1	12.9	12.0
Gross international reserves (US$ billions)	46.4	43.3	30.6	31.4	25.6	39.3	50.7	56.2	57.5	60.9	65.2	69.3
Credit to the private sector (eop, y/y percent change)	45.7	31.4	31.2	20.1	35.7	31.2	39.4	22.8	17.4	15.4	14.4	13.2
Credit to the private sector real (eop, y/y percent change)	...	...	...	...	...	...	12.8	5.6	5.0	4.9	4.7	4.2
Interest rate (eop) 2/	14.1	13.8	16.4	28.5	32.2	23.9	27.8	20.3	16.2	14.7	14.1	14.2
Real interest rate (eop) 2/	...	...	...	...	...	...	9.9	7.6	5.6	4.9	5.0	5.1

Sources: Banco Central de la República Argentina (BCRA) and Fund staff estimates.

1/ Currency in circulation outside banks plus peso-denominated deposits in checking and savings accounts.

2/ Average of all LEBAC maturities before 2017 and midpoint of the repo corridor starting in 2017; ex ante real rates.

Table 7. Argentina: External Debt, 2011–22

	2011	2012	2013	2014	2015	2016	2017 (Proj.)	2018 (Proj.)	2019 (Proj.)	2020 (Proj.)	2021 (Proj.)	2022 (Proj.)
	(Billions of U.S. dollars)											
Total external debt (gross; includes holdouts)	167.5	168.0	167.0	170.4	178.9	196.7	225.1	252.9	288.1	328.1	371.7	418.8
Percent of GDP	*31.7*	*29.0*	*27.3*	*30.2*	*28.3*	*36.1*	*36.2*	*38.8*	*39.9*	*42.4*	*45.1*	*47.8*
By maturity												
Long-term	90.6	89.6	88.0	101.0	84.3	130.5	149.3	167.7	191.1	217.6	246.5	277.8
Short-term (includes arrears)	65.7	66.9	67.5	57.8	83.1	57.8	66.1	74.3	84.6	96.3	109.1	123.0
Of which: Public sector	12.7	10.9	10.7	4.6	27.8	15.0	17.2	19.3	22.0	25.0	28.4	32.0
By type of creditor												
Debt to official creditors	30.4	28.1	26.5	38.4	46.0	50.3	51.0	55.9	61.7	68.3	75.8	84.4
Debt to banks	8.9	9.0	8.3	7.5	6.2	6.5	7.5	8.4	9.6	10.9	12.3	13.9
Debt to other private creditors	128.2	130.8	132.1	124.5	126.7	139.8	166.6	188.6	216.9	248.9	283.5	320.5
By type of debtor												
Official debt	103.8	103.3	103.0	109.9	113.2	135.9	160.3	185.6	213.5	243.8	277.8	315.4
Bank debt	5.4	4.2	4.3	4.1	5.3	5.5	6.3	6.3	7.9	10.3	12.7	15.1
Non-financial private sector	58.2	60.4	59.8	56.4	60.5	55.2	58.5	60.9	66.7	73.9	81.1	88.3

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

Table 8. Argentina: Public Debt, 2011–22

	2011	2012	2013	2014	2015	2016	2017 (Proj.)	2018 (Proj.)	2019 (Proj.)	2020 (Proj.)	2021 (Proj.)	2022 (Proj.)
	(Billions of Argentine pesos)											
Gross federal debt	818	1,027	1,396	1,996	3,280	4,366	5,455	6,582	7,523	8,583	9,869	11,396
By currency:												
In domestic currency	307	399	503	666	1,210	1,401	1,804	2,333	2,618	3,006	3,566	4,367
In foreign currency	511	629	893	1,330	2,070	2,971	3,651	4,249	4,905	5,577	6,302	7,029
By residency:												
Held by external residents	309	352	471	675	1,210	1,458	1,971	2,492	3,076	3,695	4,437	5,335
Held by domestic residents	509	675	925	1,321	2,069	2,908	3,484	4,090	4,446	4,888	5,432	6,060
	(Percent of GDP)											
Gross federal debt	37.5	38.9	41.7	43.6	56.0	54.2	52.8	51.7	50.6	50.5	51.4	52.7
By currency:												
In domestic currency	14.1	15.1	15.0	14.5	20.7	17.4	17.5	18.3	17.6	17.7	18.6	20.2
In foreign currency	23.4	23.8	26.7	29.0	35.4	36.9	35.4	33.4	33.0	32.8	32.8	32.5
By residency:												
Held by external residents	14.2	13.4	14.1	14.7	20.7	18.1	19.1	19.6	20.7	21.8	23.1	24.7
Held by domestic residents	23.4	25.6	27.6	28.8	35.4	36.1	33.7	32.1	29.9	28.8	28.3	28.0

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

Table 9. Argentina: Financial Soundness Indicators, 2011–2017Q2

(Percent, end of period)

	2011	2012	2013	2014	2015	2016	2017Q2
Financial System							
Capital Adequacy							
Regulatory Capital to Risk-Weighted Assets	-	-	13.6	14.7	13.3	16.7	16.5
Regulatory Tier 1 Capital to Risk-Weighted Assets	-	-	12.5	13.7	12.4	15.2	15.1
Asset Quality							
Non-performing Loans Net of Provisions to Capital	-4.3	-3.1	-3.5	-2.9	-3.2	-2.5	-2.4
Non-performing Loans to Total Gross Loans	1.4	1.7	1.7	2.0	1.7	1.8	2.0
Earnings and Profitability							
Return on Assets	2.7	2.9	3.4	4.1	4.1	3.6	3.0
Return on Equity	25.3	25.7	29.5	32.7	32.4	29.6	26.6
Liquidity							
Liquid Assets to Total Assets (Liquid Asset Ratio)	27.7	29.1	28.8	33.2	34.3	36.4	32.4
Liquid Assets to Short Term Liabilities	43.0	45.2	42.1	49.9	53.4	54.0	49.7
Net Open Position in Foreign Exchange to Capital	42.5	43.2	71.4	21.8	21.9	19.5	16.2
Private Banks							
Capital Adequacy							
Regulatory Capital to Risk-Weighted Assets	-	-	14.4	15.2	13.7	15.2	15.1
Regulatory Tier 1 Capital to Risk-Weighted Assets	-	-	13.2	14.1	12.8	13.4	13.4
Asset Quality							
Non-performing Loans Net of Provisions to Capital	-4.4	-3.1	-3.4	-3.1	-3.5	-2.9	-2.3
Non-performing Loans to Total Gross Loans	1.4	1.8	1.7	1.9	1.5	1.6	1.9
Earnings and Profitability							
Return on Assets	3.0	3.2	3.7	4.3	4.1	3.7	3.2
Return on Equity	25.6	26.4	29.1	32.1	31.2	29.5	26.7
Public Banks							
Capital Adequacy							
Regulatory Capital to Risk-Weighted Assets	-	-	12.1	13.6	12.3	19.4	19.3
Regulatory Tier 1 Capital to Risk-Weighted Assets	-	-	11.0	12.7	11.6	18.6	18.5
Asset Quality							
Non-performing Loans Net of Provisions to Capital	-4.3	-3.6	-4.3	-3.2	-2.9	-2.4	-3.0
Non-performing Loans to Total Gross Loans	1.2	1.4	1.6	1.9	1.9	2.2	2.1
Earnings and Profitability							
Return on Assets	2.3	2.3	3.0	3.8	4.0	3.5	2.8
Return on Equity	25.2	24.9	31.2	34.5	34.8	30.2	26.5

Sources: Banco Central de la República Argentina (BCRA) and IMF.

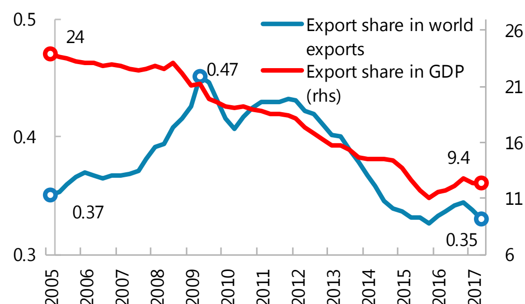
Annex I. External Sector Assessment

Argentina's external position is vulnerable to a rapidly growing current account deficit and is moderately weaker than implied by medium-term fundamentals and desirable policies. The exchange rate is assessed to be overvalued. A disorderly correction of these growing external imbalances constitutes an important vulnerability that could jeopardize the sustainability of the ongoing economic recovery.

A. Current Account

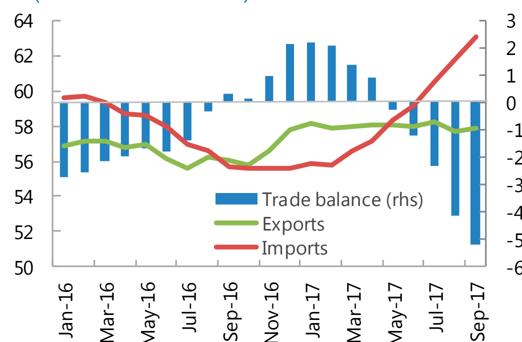
1. **The current account deficit deteriorated in 2017, driven by a worsening of the trade balance**. Argentina has experienced a decline in the export share of GDP, which fell from over 24 percent of GDP in 2005 to 9 percent in 2015. 2016 saw a modest recovery in the trade balance, to 0.8 percent of GDP from -0.1 in 2015, as the cut in export taxes on agricultural products led to the sale of previously accumulated stocks, temporarily boosting exports. The terms of trade also improved last year, as the price of fuel imports declined significantly. However, starting from early 2017, the trade balance began deteriorating, mainly reflecting a surge of import volumes (of both consumer and capital goods) as domestic demand accelerated. The terms of trade have also worsened, due to a recovery in oil prices and falling soy prices. Moreover, service imports have continued to grow rapidly, as the removal of foreign exchange restrictions and the strong peso has encouraged overseas travel by Argentine residents. Dividend payments have been broadly flat, but interest payments have grown by over 40 percent over the previous four quarters, reflecting the increasing share of debt held by non-residents. On a cumulative four quarter basis, the current account deficit reached 3.4 percent of GDP as of 2017Q2.

Export Share in GDP and Export Market Share
(Percent, 4-quarter m.a.)



Sources: Direction of Trade Statistics and IMF World Economic Outlook database.

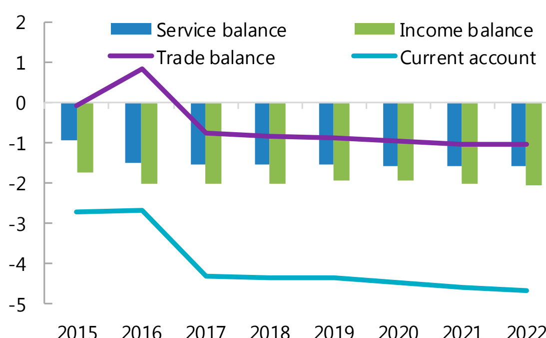
Trade flows
(Billions of U.S. dollars)



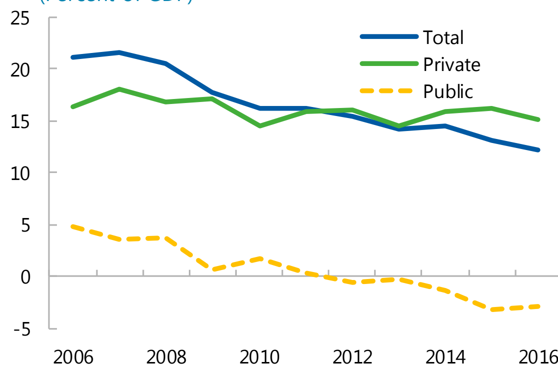
Source: INDEC.

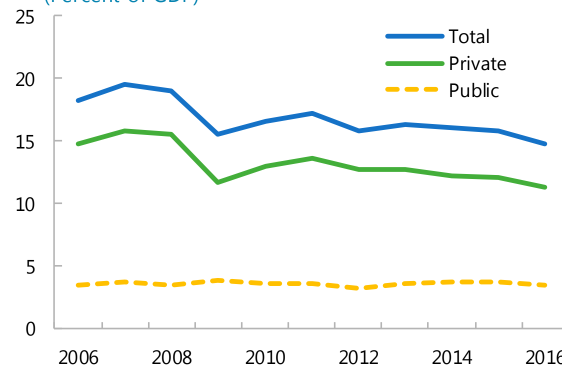
2. **The current account deficit is expected to continue to increase, slowly drifting above 4½ percent of GDP by 2022**. Stronger demand in major trading partners, notably Brazil, will boost exports but import volumes are expected to continue growing at faster rates, reflecting the gradual recovery of domestic demand. A continued strengthening of the peso will weigh on the current account as staff forecasts embed a further 8 percent rise in the real effective

exchange rate by 2022. The terms of trade are also expected to steadily deteriorate largely a result of rising fuel prices. These forces, combined with a persistent drag from the services and income balances, will lead the current account deficit to reach 4.7 percent of GDP by 2022. From a saving and investment perspective, the modest rise in national saving—largely a result of a decline in the fiscal deficit—will be more than offset by the gradual rebound of private investment, reflecting improved business confidence and better access to finance (less crowding out from the public sector).



Source: INDEC and Fund staff estimates.





Sources: INDEC and Fund staff estimates.

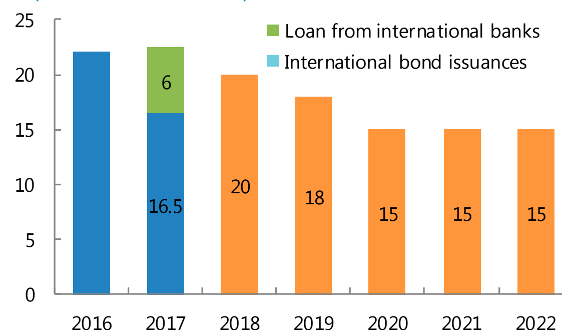
3. The 2017 cyclically-adjusted current account position is moderately weaker than the level implied by medium-term fundamentals and desirable policies. Using the approach based on the IMF's External Balance Assessment (EBA) model suggests that the 2017 current account 'norm' for a country with Argentina's characteristics should be a deficit of around 2½ percent of GDP, suggesting a gap of 1.7 percent with the 2017 predicted outturn. The overall fiscal balance in 2017 is judged to be 4 percent of GDP higher than its desirable medium-term level, accounting for the bulk of the gap between the actual current account and the estimated norm[1] Despite the planned fiscal consolidation, this policy gap is expected to persist as Argentina's major trading partners, notably Brazil, tightens fiscal policy at a faster pace than Argentina. The external stability (ES) approach suggests that the current account deficit in 2017 was 1.5 percent of GDP larger than that needed to stabilize the net international investment position (IIP) at Argentina's estimated medium-term steady-state (see 2016 Article IV, Selected Issue Papers).

[1] This is consistent with the simulation scenario presented in the Staff Report, where such an adjustment would balance the fiscal deficit and put the debt-to-GDP ratio on a clear downward trajectory.

B. Capital and Financial Accounts

4. Argentina's growing current account deficit has been mainly funded by debt-creating portfolio flows, especially to the public sector. In 2016, gross bond issuance amounted to US$35 billion (5.7 percent of GDP), 60 percent issued by the federal government and a further 20 percent issued by the provinces. In 2017, the federal government issued a similar amount of external debt, and borrowing will remain elevated in coming years. Foreign direct investment (FDI) remains low, at only ¾ percent of GDP as of 2017: Q2 (cumulative over the last four quarters) compared to an average 1.5 percent of GDP during 2006-16. This possibly reflects a still-uncertain political climate and international investors' desire to see sustained progress in advancing structural reforms. Meanwhile, net inflows from international financial institutions have largely been offset by the repayment of Paris Club loans.

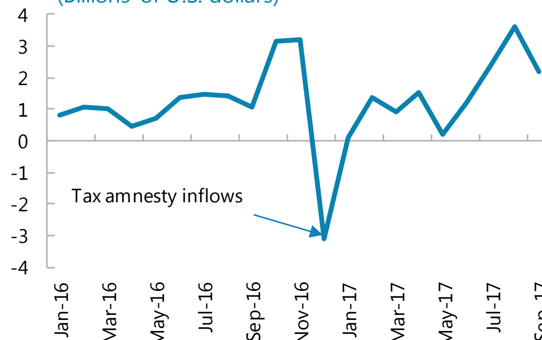
Federal Fiscal Financing in International Markets
(Billions of U.S. dollars)



Sources: Ministry of Finance and Fund staff estimates.

5. Capital outflows by residents have continued in 2017, extending a trend that began with the lifting of capital flow management measures last year.[2] The only exception to this trend was in end-2016 as residents repatriated assets during the tax amnesty. Dollar deposits also rose (to one quarter of all deposits) as exchange rate volatility increased. Non-resident inflows have gone largely into high-yield local currency debt (net non-resident inflows from January-September 2017 were US$7.4 billion).

Capital Outflows
(Billions of U.S. dollars)



Sources: BCRA and Fund staff calculations.

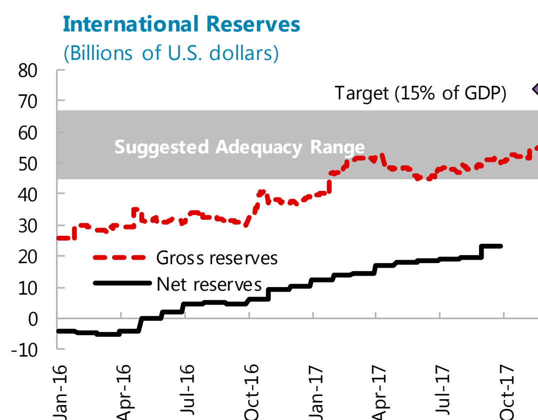
6. FDI and private sector debt issuance are expected to become larger sources of funding of the current account deficit over the medium term. Net public debt issuances remain significant under staff baseline, but the government is expected to become less reliant on international markets as the fiscal deficit declines and domestic markets deepen. Private debt issuance will steadily grow as investment picks up, and FDI is expected to gradually rebound (to 2 percent of GDP over the medium term). Outflows from Argentine residents are expected to

[2] The few remaining capital flow management measures on outflows (FX repatriation and surrender requirements on some exports and the requirement to sell FX on the local market) were removed this year (see Decree 897/2017 and BCRA Communication A 6150), in line with the IMF's institutional view on capital flows.

persist, but should decline in importance as disinflation takes hold and confidence grows in peso assets as a store of wealth.

C. FX Intervention and Reserves

7. Large scale bond issuance by the government has allowed the central bank to rebuild international reserves. The current level (US$52 billion) is 115 percent of the Fund's reserve adequacy metric although net reserves are substantially lower (largely due to the US$10.4 billion swap arrangement with the People Bank of China, which was renewed for a further three–year period in July 2017).

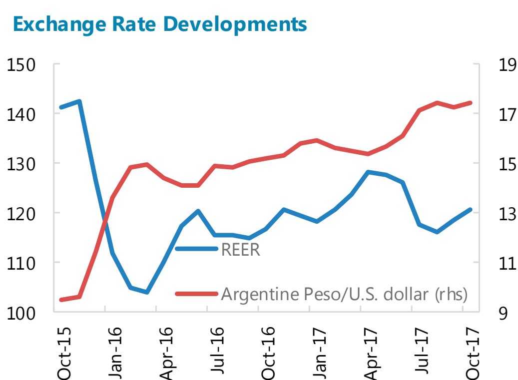


Sources: BCRA and Fund Staff calculations.

8. The authorities have announced a target level of reserves of 15 percent of GDP (US$93 billion at 2017 GDP). The BCRA began daily open market purchases of foreign exchange in US$100 million increments in May. However, this was suspended after 11 days due to a period of exchange rate volatility. As pressure on the currency grew in July and August, the authorities sold US$1.8 billion of reserves. Under current assumptions, reserves are projected to continue growing in coming years, reaching US$70 billion by 2022 (around 8 percent of GDP or 110 percent of the Fund's reserve adequacy metric).

D. Real Exchange Rate

9. The real effective exchange rate (REER) has remained broadly stable in 2017. After depreciating about 40 percent between November 2015 and March 2016, following the removal of FX restrictions and the lifting of the peg, the REER steadily appreciated, as debt inflows stabilized the nominal exchange rate while the inflation differential with trading partners widened. Appreciation continued in early 2017, but was interrupted abruptly in June–July this year, when election-related uncertainty led to significant capital outflows (doubling in July the monthly average for 2017). As a result, the REER now stands at close to its January 2017 level, 20 percent more depreciated than at end-2015.

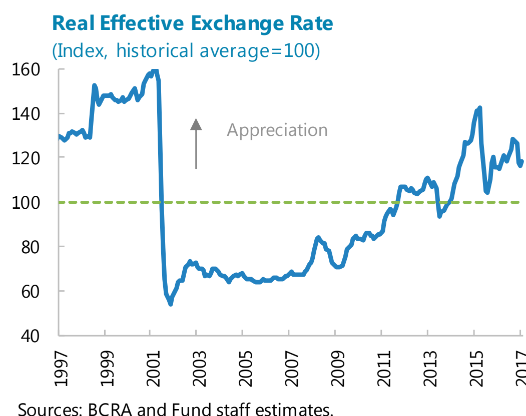


Source: BCRA.

10. The REER is assessed to be overvalued within a range of 10–25 percent compared to the level implied by medium-term fundamentals and desirable policies. The IMF's EBA

exchange rate model shows that at the end of 2017 the REER is 10 percent more appreciated than the level implied by fundamentals. Applying an elasticity of -0.06 to the relationship between the CA and the REER implies that closing the 1.5 percent of GDP gap between the estimated CA norms and the 2017 projected CA outturn would require the REER to depreciate by around 25 percent.[3] A longer term view of the REER and prices also suggests that the exchange rate may be somewhat overvalued. Compared to the 1997–2017 average (the longest time series available), the REER is around 20 percent higher. And compared to the price of a basket of identical goods in the United States, the peso is estimated to be between 5 to 20 percent overvalued.

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



Sources: BCRA and Fund staff estimates.

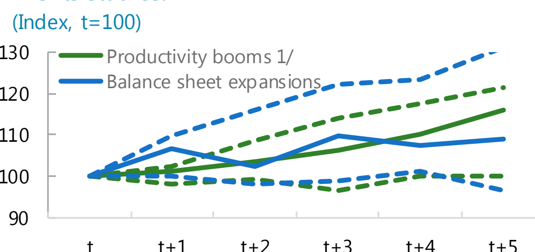
Exchange Rate Assessment Tools

	Level 2017	'Norms'	REER gap (percent)
EBA - exchange rate, Index	105.6	95.2	10.4
EBA - current account, % GDP	-4.3	-2.6	26.2
ES approach - current account, % GDP	-4.3	-2.9	23.5

Source: Fund staff estimates.
Note: Based on a elasticity of current account to REER of -0.06.

11. **Going forward, the combination of external balance sheet expansion and productivity improvements is likely to drive further real appreciation**. Staff's baseline assumes continued modest appreciation of the REER over the next four years (by an average of 2 percent per year). This reflects the combination of continued large capital inflows that support the nominal exchange rate (especially as private companies and financial institutions gain greater access to international finance) and inflation that remains above that of trading partners. To mitigate the appreciation translating into even greater overvaluation will require significant effort on supply-side reforms to raise productivity. Staff analysis shows that countries that have gone through a similar external balance sheet

Events studies: REER
(Index, t=100)



Source: Fund staff estimates.
Note: 1/ Productivty booms: Penn World Tables TFP data is used to identify 67 positive productivity shocks, defined as those countries that experienced TFP growth in the top 75th percentile for three years. Balance sheet expansions. See Argentina: Selected Issues, October 2016, *Medium Term Prospects for Argentina's External Balance Sheet*.

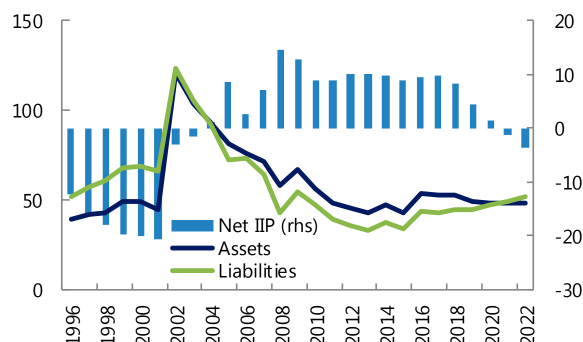
[3] This is based on an elasticity of imports and exports to the exchange rate of 0.29 and -0.20, respectively; and an import and export share of GDP of 13.5 and 12.2 percent, respectively. The elasticity with respect to the current account (-0.06) is fairly small compared to other countries, owing to the relatively low degree of trade openness of Argentina's economy and the estimated low elasticity of exports to the exchange rate (see 2016 Selected Issues Paper).

expansion experienced an average REER appreciation of 3.2 percent per year. Moreover, countries that experienced significant and persistent TFP growth in the past fifty years (those in the top 75th percentile when considering average annual TFP growth for a period of at least three years) have experienced almost 2 percent real appreciation a year.

E. External Balance Sheet

12. The net IIP position continued to deteriorate in 2017. External liabilities rose sharply in 2016 and the first half of 2017, by almost 10 percentage points of GDP relative to the end of 2015, following significant external borrowing by the public sector and the depreciation of the exchange rate. However, the largely dollar denominated external asset position meant that the exchange rate shock had relatively small effects on the net position.

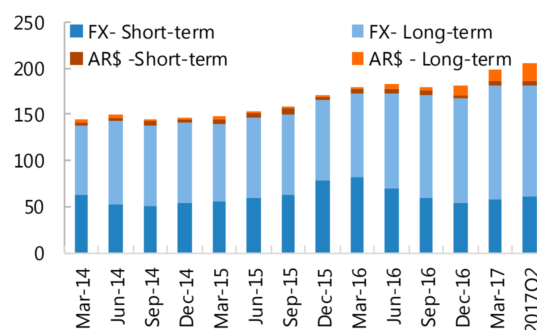
Net International Investment Position
(Percent of GDP)



Sources: INDEC and Fund staff calculations.

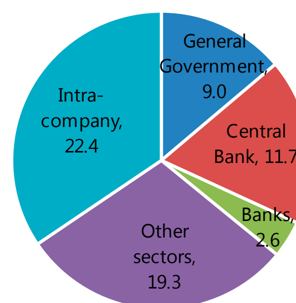
13. A reliance on debt poses balance sheet risks. Low levels of FDI and high public sector borrowing meant that only 25 percent of liabilities are in the form of equity (compared to a regional average of 40 percent). While the country's overall IIP is currently stronger than in the build up to the 2001/02 crisis, a continued deterioration fueled by a heavy reliance on debt financing can raise balance sheet vulnerabilities, as the buffer provided by loss absorbing instruments is small. Furthermore, around a third of debt is in the form of short-term financing, mainly intra-company lending, trade credit, and borrowing by the public sector. This means that gross external financing needs are expected to be around 20 percent of GDP in 2018 and beyond (Annex Table 1). An unexpected tightening of global liquidity conditions could lead to significant rollover risks, particularly for the public sector. Similarly, a 30 percent real depreciation would lead external debt to reach 70 percent of GDP by 2022, posing rollover and solvency risks to the government and the private sector (Annex Figure 1).

External Debt
(Billions of U.S. dollars)



Source: SDDS.

Short-term Debt by Sector
(Billions of U.S. dollars)

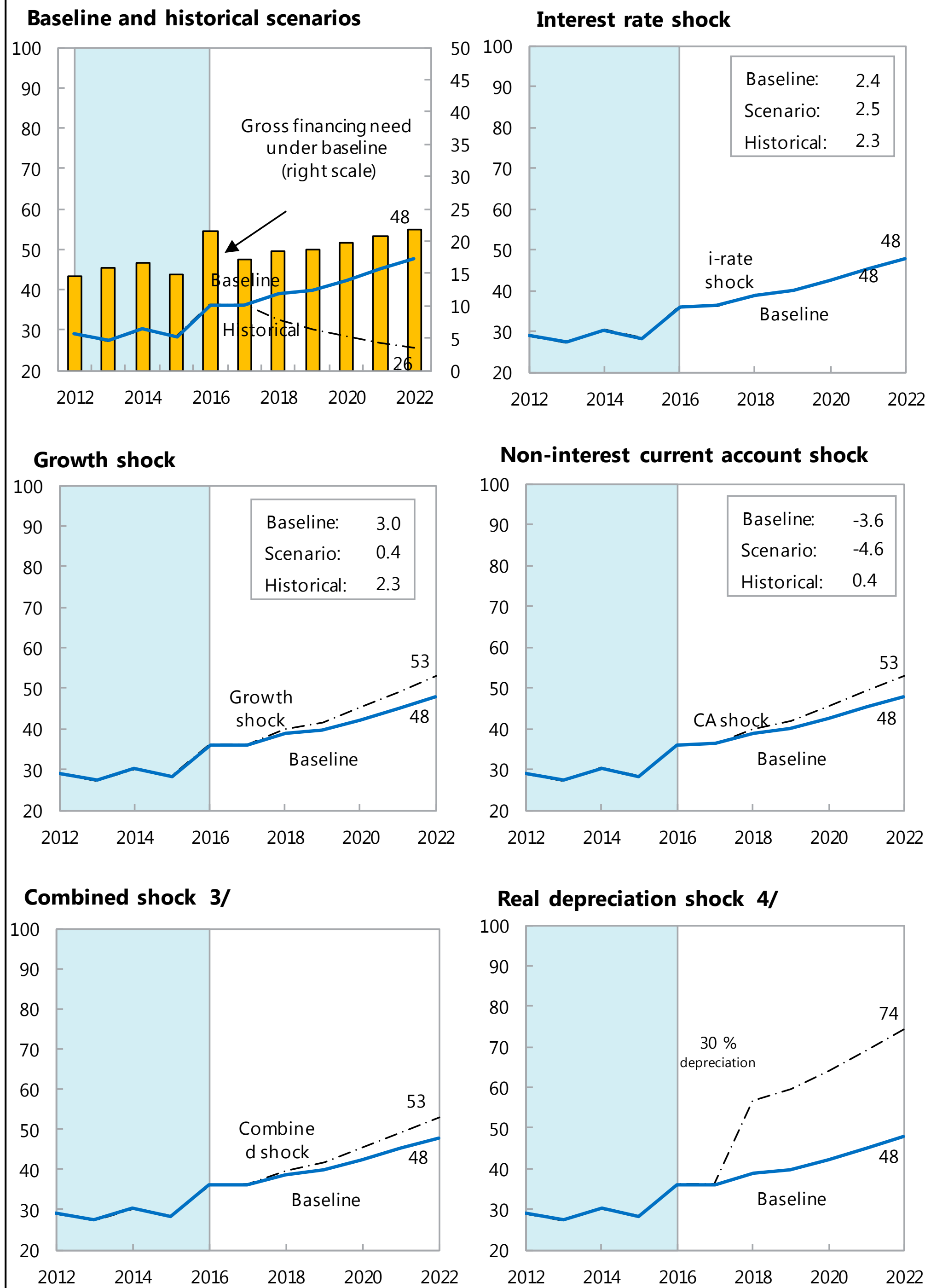


Source: INDEC.

14. Looking ahead, the net IIP position is expected to deteriorate as external liabilities increase. By 2022, continued public sector debt issuance, greater access to debt markets by the private sector, and a recovery in FDI will cause external liabilities to grow substantially. External assets will grow more modestly, driven primarily by reserve accumulation. By 2022, the net IIP position is expected to become negative and reach -6 percent of GDP.

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

(External debt in percent of GDP)



Source: Fund staff calculations and estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2018.

Annex Table 1. Argentina: External Debt Sustainability Framework, 2012—22
(Percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2012	2013	2014	2015	2016			2017	2018	2019	2020	2021	2022	Debt-stabilizing non-interest current account 6/
Baseline: External debt	29.0	27.3	30.2	28.3	36.1			**36.2**	**38.8**	**39.9**	**42.4**	**45.1**	**47.8**	**-2.6**
Change in external debt	-2.8	-1.7	2.9	-1.9	7.8			0.1	2.6	1.1	2.5	2.8	2.7	
Identified external debt-creating flows (4+8+9)	-4.9	-0.9	3.3	-2.3	6.7			2.5	2.6	2.1	1.7	1.5	1.3	
Current account deficit, excluding interest payments	-0.3	1.5	0.8	2.1	1.8			3.3	3.3	3.4	3.6	3.8	3.8	
Deficit in balance of goods and services	-5.1	-3.0	-3.4	-2.0	-3.2			-1.6	-1.6	-1.6	-1.6	-1.6	-1.7	
Exports	16.3	14.7	14.5	11.1	13.0			11.8	12.2	11.9	11.9	11.9	11.9	
Imports	11.2	11.7	11.1	9.1	9.8			10.2	10.6	10.3	10.3	10.3	10.2	
Net non-debt creating capital inflows (negative)	-2.4	-1.5	-0.6	-1.8	-0.5			-0.9	-0.9	-1.2	-1.6	-1.8	-2.0	
Automatic debt dynamics 1/	-2.2	-0.9	3.0	-2.7	5.4			0.2	0.2	-0.1	-0.3	-0.4	-0.6	
Contribution from nominal interest rate	0.6	0.6	0.7	0.6	0.9			1.1	1.0	0.9	0.9	0.8	0.8	
Contribution from real GDP growth	0.3	-0.7	0.7	-0.7	0.7			-0.9	-0.9	-1.0	-1.2	-1.2	-1.4	
Contribution from price and exchange rate changes 2/	-3.2	-0.8	1.6	-2.5	3.8			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	2.2	-0.8	-0.4	0.4	1.0			-2.4	0.0	-1.0	0.7	1.2	1.4	
External debt-to-exports ratio (in percent)	178.1	186.4	208.2	255.5	278.6			307.7	318.5	335.5	357.0	379.0	402.7	
Gross external financing need (in billions of US dollars) 4/	84.6	96.7	93.2	92.8	117.3			107.2	119.8	134.5	152.1	171.6	192.1	
in percent of GDP	14.6	15.8	16.5	14.7	21.5	10-Year	10-Year	17.2	18.4	18.6	19.6	20.8	21.9	
Scenario with key variables at their historical averages 5/								**36.2**	**32.6**	**30.2**	**28.3**	**26.8**	**25.5**	**-3.3**
						Historical	Standard							
Key Macroeconomic Assumptions Underlying Baseline						Average	Deviation							
Nominal GDP (US dollars)	579.7	611.5	563.6	631.6	544.7			621.8	651.8	722.3	775.1	825.1	877.4	
Real GDP growth (in percent)	-1.0	2.4	-2.5	2.6	-2.2	2.3	5.2	2.8	2.5	2.8	3.1	3.1	3.2	
GDP deflator in US dollars (change in percent)	11.0	3.0	-5.5	9.2	-11.8	7.1	10.8	11.0	2.3	7.8	4.1	3.2	3.0	
Nominal external interest rate (in percent)	2.2	2.3	2.4	2.2	2.7	2.3	0.3	3.4	3.0	2.7	2.4	2.1	1.9	
Growth of exports (US dollar terms, in percent)	-3.4	-5.0	-8.7	-14.4	0.8	3.8	16.4	3.6	8.5	8.2	7.1	6.8	6.1	
Growth of imports (US dollar terms, in percent)	-8.1	9.6	-12.4	-8.4	-6.9	7.7	25.0	19.0	8.7	7.7	7.2	6.8	5.0	
Current account balance, excluding interest payments	0.3	-1.5	-0.8	-2.1	-1.8	0.4	2.1	-3.3	-3.3	-3.4	-3.6	-3.8	-3.8	
Net non-debt creating capital inflows	2.4	1.5	0.6	1.8	0.5	1.6	0.7	0.9	0.9	1.2	1.6	1.8	2.0	

Source: Fund staff calculations and estimates.

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

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

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

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

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

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

INTERNATIONAL MONETARY FUND

ARGENTINA

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

December 1, 2017

Prepared By

The Western Hemisphere Department
(In consultation with other departments)

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FUND RELATIONS

The 2017 Article IV discussions were held in Buenos Aires during October 30–November 10, 2017. The staff team comprised R. Cardarelli (head), L. Lusinyan, J. Canales-Kriljenko (all WHD), P. Dudine (FAD), A. Pienkowski (SPR), and F. Figueroa (LEG). J. A. Sarmiento Monroy (WHD) provided research assistance. Mr. Werner (WHD) joined the concluding meetings. The mission met with senior officials and representatives of private sector, finance industry, academics, and think-tanks. Mr. Lopetegui (OED) participated in the meetings.

Membership Status: Joined September 20, 1956; Article VIII

(As of October 31, 2017)

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

SDR Department:	**SDR Million**	**Percent of Quota**
Net cumulative allocation	2,020.04	100.00
Holdings	1,785.17	88.37

Outstanding Purchases and Loans: None.

Latest Financial Arrangements:

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

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

	Forthcoming				
	2017	2018	2019	2020	2021
Principal					
Charges/Interest	0.33	1.54	1.54	1.54	1.54
Total	0.33	1.54	1.54	1.54	1.54

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

Implementation of HIPC Initiative: Not Applicable.

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

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

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

Last Article IV Consultation: The Staff Report for the 2016 Article IV Consultation with Argentina was considered by the Executive Board on November 9, 2016.

STATISTICAL ISSUES

(As of October 31, 2017)

I. Assessment of Data Adequacy for Surveillance

General: Data provision is adequate for surveillance, although structural breaks in several macroeconomic series (including CPI, employment, unemployment, poverty) hamper empirical analysis. At its November 9, 2016, meeting, the IMF Executive Board lifted the declaration of censure issued in 2013.

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

Price statistics: A new CPI was disseminated in June 2016, with coverage restricted to Greater Buenos Aires. At its November 9, 2016, meeting, the IMF Executive Board considered the new CPI series to be in line with international standards and lifted the declaration of censure issued in 2013. A new national CPI has been disseminated starting in June 2017.

Government Finance Statistics: Argentina disseminates data for central government operations and debt, and they have re-started to submit GFS data to the Statistics Department for the last GFSY on Expenses, Revenues and Transactions in Assets and Liabilities.

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

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

External sector statistics: Argentina disseminates timely balance of payments, International Investment Position (IIP), external debt, and the statistical framework of international reserves and foreign currency liquidity. At the request of the authorities, a technical assistance mission on external sector statistics visited the INDEC in November 2016 and April 2017. Starting in September 2017, the INDEC is publishing the international accounts—jointly presenting in a single technical report the quarterly statistics of Balance of Payments, External Debt and the International Investment Position—following the recommendations of the sixth edition of the Balance of Payments and International Investment Position Manual (BPM6). More recently, Argentina provided for the first time data to the IMF on the Coordinated Direct Investment Survey (CDIS), to be disseminated around end-December 2017.

II. Data Standards and Quality

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

No Data ROSC has been conducted.

III. Data Submission to STA

Argentina has resumed reporting GFS data for publication in International Financial Statistics in 2017.

RELATIONS WITH THE WORLD BANK[1]

The current Country Partnership Strategy (CPS) (FY15–FY18) was presented to the World Bank's Board of Executive Directors in September 2014. It was developed in consultations with the Government and is built around nine specific results, most of which are aligned with the goal of eradicating poverty (e.g. ensuring access to safe drinking water; youth insertion into labor market; effective health care coverage; and improving the environment). The initial phase until December 2015 was focused on operations providing direct household support for the poorest in Argentina, mostly in the social and rural sectors. The engagement has significantly broadened since 2016.

New operations include large infrastructure works for flood protection, water and sanitation, and urban transformation. The World Bank Group also supported the Government in its first tendering of private renewable energy production (the RenovAR program) with a US$480 million guarantee. Policy advice and analytical studies have similarly expanded in a major way and now cover core structural reform areas including the financial sector and capital markets, housing finance, trade and competition.

In FY18, the IBRD portfolio in Argentina consists of 25 projects, including 22 investment loans, one guarantee and two trust fund grants for a total commitment of US$6.1 billion (average size of US$250 million). The overall indicative lending envelope for the four-year CPS period is between US$4 billion and US$4.8 billion, of which an amount of US$3.9 billion has already been committed. The portfolio includes eighteen new operations approved by the Board under the new Country Partnership Strategy.

As of October 31, 2017, IFC's committed portfolio has reached approximately US$2.9 billion, including US$1.6 billion mobilized from third parties. There are 42 active clients, including regional ones with headquarters and operations based in Argentina. Today, Argentina's portfolio represents approximately 10 percent of IFC's committed portfolio for the LAC region. Under the current CPS, IFC has provided US$2.8 billion in long term financing, of which US$1.8 billion was mobilized from third parties. IFC also committed short-term trade financing in the amount of US$857 million over the same period. These investments included, among others, a US$500 million investment in Personal, a telecom company, to develop its 4G LTE broadband network; US$410 million for Renova, a company focused on soy crushing; US$50 million equity investment in Los Grobo, a leading agribusiness company; and a US$50 million loan to the City of Buenos Aires for urban transportation projects, IFC's first municipal investment in Argentina (these amounts include mobilization). In FY18, IFC has so far provided US$167 million in long term financing in infrastructure, renewable energy and manufacturing projects, and an additional US$59 million in short-term trade financing.

[1] Prepared by the World Bank staff.

RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK[1]

Argentina's current Country Strategy covers the period 2016–19 and focuses on interventions and funding for three critical areas: (i) improvement of business climate; (ii) strengthening of economic integration and private sector insertion in global value chains; and (iii) reduction of poverty and inequality. Although the Strategy will support interventions in all regions of the country, it will continue to focus the support in the Norte Grande region and the Greater Buenos Aires area, where persists significant income and sectoral development gaps. The Strategy will support the Belgrano Plan for the Norte Grande region, especially in the areas of infrastructure, access to basic services and poverty reduction. Interventions and lending in the Greater Buenos Aires area will focus on supporting the Pobreza Cero Plan, particularly in the areas of early childhood development and of improving the water and sanitation services. Approvals for the period are projected at US$6 billion, including regional projects already identified with other countries, subject to the availability of Bank financial capital. This figure will be augmented by lending to the private sector by IDB Invest. The IDB is the main multilateral creditor of Argentina with a total debt owed of US$ 11.4 billion in 2016 (56.5 percent of Argentina's total multilateral debt).

Under the 2016–19 Strategy the following initiatives were approved so far: 16 sovereign guarantee operations totaling US$2.3 billion, 60 private sector (non-sovereign guarantee) operations totaling US$514 million, and 21 non-reimbursable technical cooperation for US$5.9 million.

As of November 2017, Argentina's sovereign loan portfolio is composed of 60 operations, totaling US$9.8 billion, with a disbursed percentage of 50 percent. The portfolio is distributed as follows: 62 percent dedicated to projects in the areas of infrastructure and energy, 17 percent in climate change and sustainable development, 12 percent in institutions for development, 8 percent in social sector, and 1 percent in integration and trade. Additionally, the private sector loans portfolio comprises 18 operations with an approved value of US$703 million, and the non-reimbursable technical cooperation portfolio includes 39 operations, with an approved value of US$37 million.

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

Argentina: Approved operations under the 2016–19 Strategy*		
	Number of operations	Amount (US$ million)
Sovereign guarantee**	16	2,286.6
Non-sovereign guarantee	60	514
Technical cooperation**	21	5.9

*In the transition period between strategies from January 1st to November 15th 2016, there were 2 sovereign guarantee operations for US$420 million, 22 private sector operations totaling US$153 million, and 1 technical cooperation for $0.2 million.
**Excluding regional operations.

Argentina IDB Portfolio by type of operation* (As of November 10, 2017)		
	Number of operations	Amount (US$ million)
Sovereign guarantee	60	9,816.5
Non-sovereign guarantee**	18	702.6
Technical cooperation	39	37

*Excluding closed and fully disbursed operations.
**As of September 30, 2017

Argentina Sovereign Loan Portfolio by sector* (As of November 10, 2017)			
Sectors	Number of operations	Current approved (US$ million)	Disbursed (Percent)
Infrastructure and Energy	22	6,095	53.8
Institutions for Development	17	1231.9	37.1
Climate Change and Sustainable Development	15	1,633	52.6
Social Sector	4	780	40.2
Integration and Trade	2	76.3	3.5
TOTAL	**60**	**9,816.2**	**50**

*Excluding closed and fully disbursed operations.

Argentina—Table of Common Indicators Required for Surveillance

(As of November 14, 2017)

	Date of latest observation	Date received	Frequency of data[6]	Frequency of reporting[6]	Frequency of publication[6]
Exchange Rates	November 14, 2017	November 14, 2017	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	November 14, 2017	November 14, 2017	D	D	D
Reserve/Base Money	November 10, 2017	November 10, 2017	D	D	D
Broad Money	November 10, 2017	November 10, 2017	D	D	D
Central Bank Balance Sheet	September 2017	October 2017	M	M	M
Consolidated Balance Sheet of the Banking System	September 2017	October 2017	M	M	M
Interest Rates[2]	November 10, 2017	November 10, 2017	D	D	D
Consumer Price Index	October 2017	November 14, 2017	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2016	February 2017	A	A	A
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	September 2017	October 20, 2017	M	M	M
Stocks of Central Government and Central Government –Guaranteed Debt[5]	Q1 2017	June 30, 2017	Q	Q	Q
External Current Account Balance	Q2 2017	September 27, 2017	Q	Q	Q
Exports and Imports of Goods	September 2017	October 24, 2017	M	M	M
GDP/GNP	Q2 2017	September 21, 2017	Q	Q	Q
Gross External Debt	Q2 2017	September 27, 2017	Q	Q	Q
International Investment Position[7]	Q2 2017	September 27, 2017	Q	Q	Q

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

INTERNATIONAL MONETARY FUND

ARGENTINA

December 1, 2017

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITYANALYSIS

Approved By
Nigel Chalk and Daria Zakharova

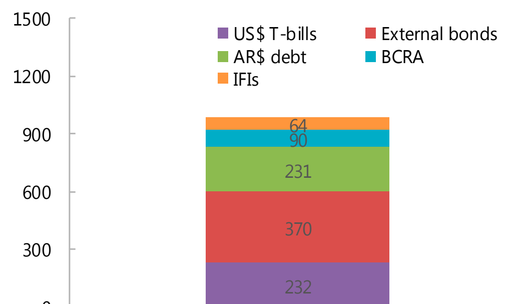
The Western Hemisphere Department
(In consultation with other departments)

Debt vulnerabilities have risen as the external imbalances have grown, making fiscal consolidation essential to secure debt sustainability. Federal government debt is expected to remain slightly above 50 percent of GDP over the medium term. The positive effect from a declining primary deficit and improved growth is likely to be matched by higher real interest rates, as the government shifts to greater market borrowing. Risks to solvency are moderate, but the high share of foreign currency denominated debt creates vulnerabilities from a large exchange rate depreciation and the normalization of global monetary conditions. Elevated gross financing needs is a risk, only partly mitigated by the high share of debt held by other public sector entities.

BACKGROUND

At end-2017, gross (including intra-public sector debt) federal government debt is expected to be AR$5,450 billion or 52.8 percent of GDP. This excludes the debt issued by the provinces (Box 1), ANSES and the BCRA; and excludes the nominal value of around AR$200 billion of GDP-warrants.

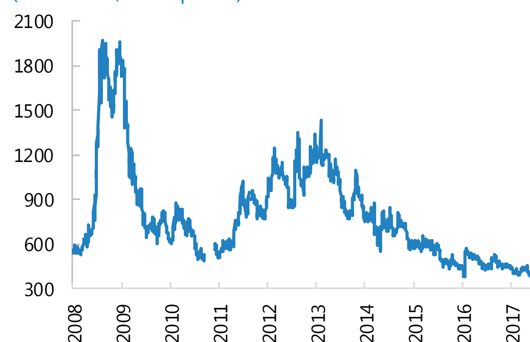
Estimated Debt Issuance in 2017
(Billions of Argentine pesos)



Source: Fund staff calculations.

- ***Recent debt dynamics***. Gross federal debt is expected to decline by about 1½ percent of GDP in 2017, as the impact from the high primary deficit is offset by still elevated inflation, which will erode the nominal value of domestic debt. The stability of the gross debt-to-GDP ratio masks the decline in debt held by other public sector agencies (mainly BCRA and ANSES) and the increase of debt with the private sector, which went from 26½ percent of GDP at the end of 2015 to an estimated 28½ percent of GDP by the end of this year. This reflects the large volume of debt issuance over the last two years, primarily through international capital markets and domestic U.S. dollar-denominated treasury bills. External bond and loan issuance has been US$22.5 billion this year, with bonds spreads at historical lows. Following the tax amnesty, U.S. dollar domestic deposits grew substantially, and the authorities sought to benefit from this liquidity by issuing U.S. dollar denominated treasury bills in large amounts (US$14.1 billion).

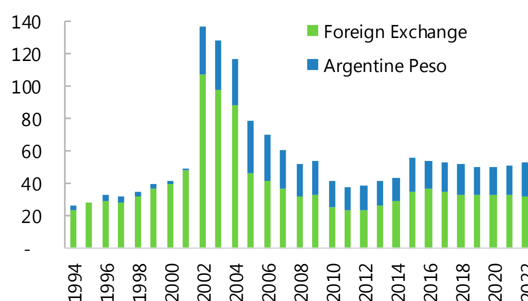
Sovereign Spread
(EMBI+ARG, basis points)



Source: JP Morgan

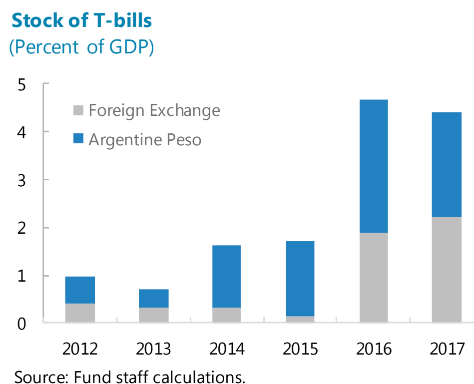
- ***Currency composition.*** Nearly 70 percent of Argentina's debt stock is denominated-in or linked-to a foreign currency, mainly the U.S. dollar. Of the peso-denominated debt, just under one-quarter is linked to inflation. While the level of foreign currency debt is similar to the late 1990s, the exchange rate was probably more overvalued then, underestimating the real burden of this debt.

Gross Federal Debt: By Currency Composition
(Percent of GDP)



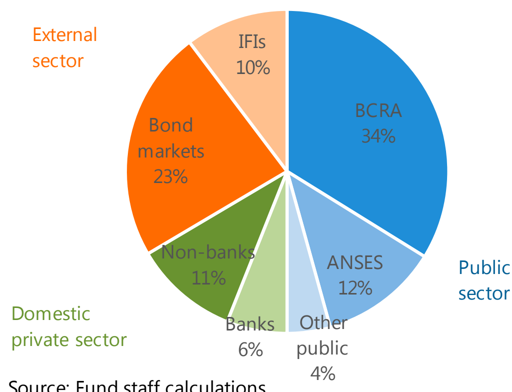
Source: Fund staff calculations.

- ***Maturity.*** The average residual maturity of Argentina's debt at end-2016 was over 13 years, which is high relative to other countries, especially emerging markets. Part of this is a result of the 2005 and 2010 debt exchanges, where many of these bonds mature in 2038. But Argentina has also been able to issue at long maturities, most notably the 100-year external bond sold in June 2017. On the other hand, there has also been a marked increase in the stock of short-term treasury bills, increasing from 2 to 4½ percent of GDP between 2015 and 2017.

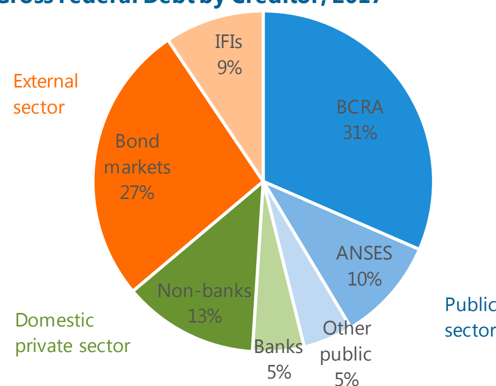


Source: Fund staff calculations.

- ***Debt holders.*** Despite the decline since the end of 2015, the federal debt held by other public sector entities continues to represent a large share of the total stock (45 percent by the end of 2017). Of this, the BCRA holds (effectively) zero-interest bonds equal to 18 percent of GDP. The share of debt held by non-residents has grown on the back of the large-scale bond issuance program. Domestically, non-banks (including retail investors and mutual funds) are estimated to hold a greater share of the debt stock, partly driven by the desire to save their tax amnesty funds in US$ T-bills. This suggests that the domestic creditor base has become more diversified.



Source: Fund staff calculations.



Box 1. Fiscal Outlook for Provinces

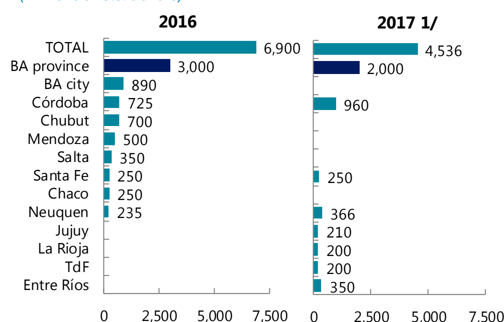
In 2017, provinces are projected to run an overall fiscal deficit of 0.9 percent of national GDP. As the federal government, they also have been active in issuing foreign currency debt on international capital markets. Over the first three quarters of 2017, external debt issuance has been US$4.5 billion, concentrated in the province of Buenos Aires, and to a lesser extent, Cordoba. Total debt of all provinces is expected to be AR$ 590 billion in 2017 (5.7 percent of national GDP), of which around a quarter is held by the federal government.

Going forward, the overall provincial fiscal deficit is expected to decline, ending in 2022 at 0.2 percent of GDP. This would lead to a slight decrease of provincial debt to 5.3 percent of GDP (and 42 percent of revenues) by 2022. While this is still below historical highs, risks remain, including:

- The overall debt level of provinces masks significant heterogeneity within the group. The ratio of debt-to-total revenues ranges from 1 (San Luis) to about 75 percent (Chubut), and those provinces that have the greatest debt-to-revenue ratios also tend to have the largest absolute debt stock, suggesting potential contingent liability risks for the federal government.

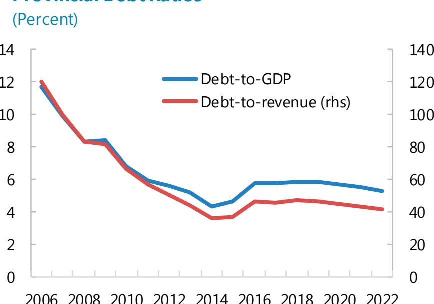
- Sixty percent of provincial debt is denominated in foreign currency, although with great heterogeneity across provinces (with this share varying between 0 and 90 percent). A sharp depreciation of the exchange rate would raise the debt level, potentially jeopardizing continued market access and forcing a sizeable fiscal adjustment. For example, an additional 20 percent depreciation in 2018 would increase debt by 0.6 percent of GDP (to 6.4 percent of GDP).

Provincial Debt Issuance in External Markets
(Millions of U.S. dollars)



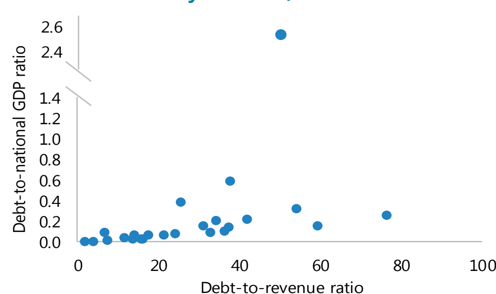
Source: Dealogic.
1/ October 9, 2017.

Provincial Debt Ratios
(Percent)



Source: Ministry of Finance and Fund staff estimates.

Debt Indicators by Province, 2016



Source: Fund staff calculations.

A. Baseline Scenario

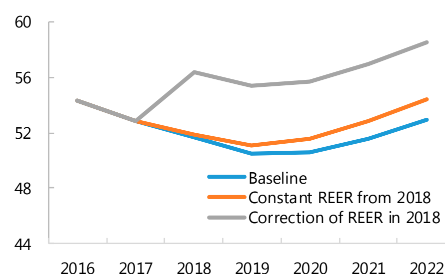
Debt is expected to remain relatively flat over the forecast horizon at slightly above 50 percent of GDP, well below the 'high risk' threshold of 70 percent for emerging markets. By 2022, debt is expected to be about 53 percent of GDP, while the share held by private creditors and IFIs will grow from 27 percent of GDP in 2016 to 35 percent in 2022, reflecting the shift towards market financing. Gross financing needs (GFN) are expected to remain elevated, but declining somewhat after 2018. GFN in 2018 only narrowly miss breaching the 15 percent high risk threshold for emerging markets. This projection is based on the following assumptions:

- ***Growth and inflation.*** Growth is expected to recover in 2017 and slowly accelerate to about 3 percent by 2020. While inflation will gradually decline over the forecast period, it will continue to erode the real value of long-maturity peso denominated debt (mainly held by the BCRA), supporting debt dynamics.

- ***Primary deficit.*** Fiscal consolidation in 2018 and 2019 will have a short-run negative impact on growth, but will help to contain the accumulation of debt going forwards. In staff baseline, a persistent primary deficit of around 2 percent of GDP is expected to remain from 2020 onwards.

- ***Exchange rate.*** A real exchange rate appreciation is expected to support debt dynamics, although this effect is likely to be smaller in the medium term. No correction of the estimated peso overvaluation (see Annex I) is expected, but this remains a risk. If the exchange rate were to realign in 2018 with the level predicted by fundamentals, debt-to-GDP would peak at around 60 percent of GDP in 2022.

Gross Federal Debt
(Percent of GDP)



Source: Fund staff estimates.

- ***Financing assumptions.*** The share of financing from the public sector, notably the advances from the BCRA, will decline over the horizon period (Table 1). Domestic creditors, in particular the non-banking sector, will provide part of the remaining financing, but the majority is expected to come from international markets, with net issuance of around US$15 billion a year. The increase in the reliance on T-bills witnessed in 2016 and 2017 is expected to rollover across the projection period. Taken together, the average effective interest rate on total debt is expected to increase from 4 percent in 2016 to 9½ percent in 2022.

B. Shocks and Stress Tests

Solvency risks

- Given the high share of foreign currency denominated debt, a shock to the exchange rate is a major vulnerability. The standard DSA stress test (50 percent real depreciation with 0.25 pass-through) shows that debt could jump to 66 percent of GDP in such a scenario, only slightly below the high-risk threshold. Debt is also vulnerable to a growth shock, which under the stress test could raise debt to 65 percent of GDP. Given the relatively long debt maturity profile, a shock to interest rates is not a major risk.

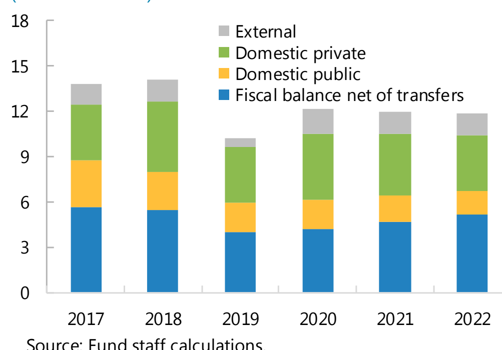
- Fiscal consolidation is critical to stabilizing the debt level. If the primary balance were to remain unchanged at its 2016 level (-4.2 percent of GDP), debt would follow an upward trajectory,

exceeding 60 percent of GDP by 2022. A 'combined macro-fiscal' shock would cause debt to rise to 90 percent of GDP, likely triggering a crisis.[1]

Liquidity risks

- High GFN, financed largely through external issuance, will leave Argentina exposed to global liquidity conditions. Stress test shocks to the exchange rate (perhaps driven by an increase in global risk aversion) or growth will generate GFN close to 19 percent of GDP, significantly above the high-risk threshold for emerging markets. A combined macro-fiscal shock will lead to GFN of 24 percent of GDP. In such a scenario, it may not be possible to finance this through market access, triggering the need for steep fiscal consolidation and/or direct financing from the BCRA.

Gross Financing Needs by Source
(Percent of GDP)



Source: Fund staff calculations.

- Liquidity risks are somewhat mitigated by the significant share of debt held by public sector entities. However, while the public sector holds around half of the federal debt stock, the contribution of this debt to the medium-term GFN profile is relatively small. Over 2017-22, less than one-fifth of the GFN is driven by the amortization of publicly-held federal debt. Even if these principal payments were rolled over in full, a significant GFN profile would remain.

[1] This involves – i) a one-standard deviation shock to growth, with the corresponding automatic stabilizers and lower inflation; ii) a 50 percent real depreciation, with 0.25 pass-through to inflation; and iii) 200bps shock to interest rates.

Argentina Federal Government: Funding Needs and Sources

	2016	2017	2018	2019	2020	2021	2022
(Billions of U.S. dollars, unless otherwise indicated)							
Primary deficit	**23.2**	**25.9**	**20.8**	**15.8**	**15.6**	**16.0**	**16.2**
Percent of GDP	*4.3*	*4.2*	*3.2*	*2.2*	*2.0*	*1.9*	*1.8*
Interest payments	8.9	13.1	14.8	18.0	19.6	24.5	30.0
Overall balance	**32.1**	**38.9**	**35.6**	**33.8**	**35.2**	**40.5**	**46.2**
Percent of GDP	*5.9*	*6.3*	*5.5*	*4.7*	*4.5*	*4.9*	*5.3*
Amortization	**33.4**	**51.8**	**57.0**	**44.9**	**61.4**	**60.0**	**58.9**
Percent of GDP	*6.1*	*8.3*	*8.7*	*6.2*	*7.9*	*7.3*	*6.7*
Amortization (net of public sector)	**23.4**	**32.4**	**40.7**	**31.0**	**46.0**	**45.6**	**45.3**
Percent of GDP	*4.3*	*5.2*	*6.3*	*4.3*	*5.9*	*5.5*	*5.2*
Gross financing needs	**65.5**	**90.7**	**92.6**	**78.8**	**96.6**	**100.5**	**105.1**
Percent of GDP	*12.0*	*14.6*	*14.2*	*10.9*	*12.5*	*12.2*	*12.0*
Gross financing needs (net of public sector)	**55.5**	**71.4**	**76.3**	**64.9**	**81.2**	**86.1**	**91.5**
Percent of GDP	*10.2*	*11.5*	*11.7*	*9.0*	*10.5*	*10.5*	*10.4*
Total net new financing	**32.2**	**38.8**	**35.6**	**33.9**	**35.2**	**40.5**	**46.2**
Percent of GDP	*5.9*	*6.3*	*5.5*	*4.7*	*4.5*	*4.9*	*5.3*
BCRA profit transfer	**7.4**	**3.6**	**0.0**	**4.9**	**2.6**	**1.5**	**0.8**
Borrowing	**24.8**	**35.2**	**35.6**	**28.9**	**32.6**	**39.0**	**45.4**
Intra-public sector (excl. Banco Nacion)	8.9	11.2	16.9	1.8	2.6	2.0	1.6
BCRA advances	5.4	5.4	7.2	0.4	1.1	0.6	0.2
ANSES (FGS)	2.0	1.6	3.2	0.4	0.6	0.5	0.5
Other government agencies	1.5	4.2	6.5	1.0	1.0	0.9	0.9
Domestic creditors	5.3	5.7	2.4	7.2	10.5	14.6	18.8
Banking sector (incl. Banco Nacion)	1.0	0.2	0.5	0.7	0.8	1.0	1.2
Non-banking sector	4.4	5.6	1.9	6.5	9.7	13.7	17.6
External creditors 1/	10.5	18.3	16.4	19.9	19.5	22.3	25.0
IFIs	0.2	2.0	3.0	4.2	5.2	6.3	7.5
Paris Club & other official	-1.0	-2.0	-2.0	-0.2	-0.2	-0.2	-0.2
Private bonds	11.3	18.2	15.3	15.9	14.5	16.1	17.7
Other (valuation effects)	**-0.1**	**0.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Memo items (percent of GDP):							
Federal gross debt	54.2	52.8	51.7	50.6	50.5	51.4	52.7
Federal gross debt to public sector	27.2	24.4	23.1	21.3	19.9	18.8	17.8
Federal gross debt to private sector and IFIs	27.1	28.5	28.6	29.2	30.7	32.6	34.9

Source: Fund staff calculations and estimates.

1/ Includes repayment to holdout creditors of US$9.5 billion in 2016.

Argentina Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

(in percent of GDP unless otherwise indicated)

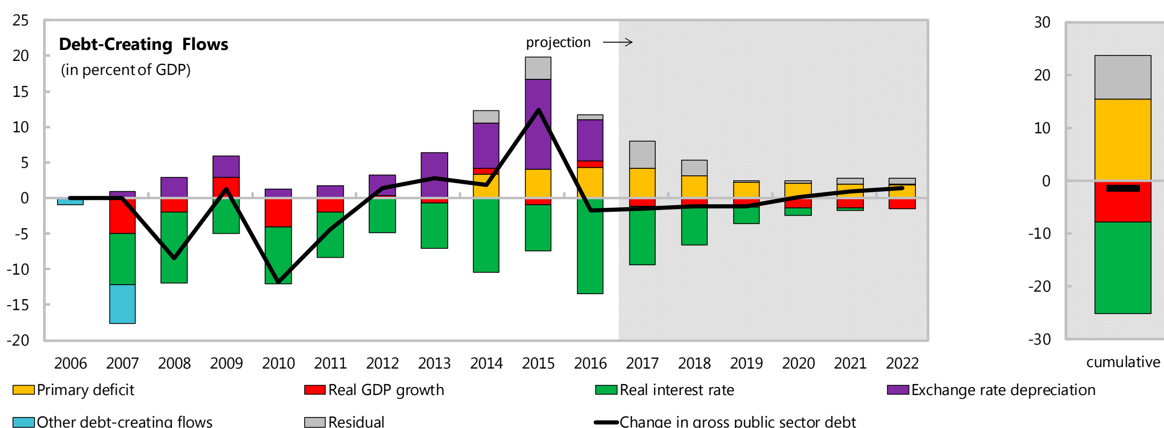
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2006-2014 [2/]	2015	2016	2017	2018	2019	2020	2021	2022
Nominal gross public debt	49.0	56.0	54.3	52.8	51.7	50.5	50.6	51.5	52.9
Public gross financing needs	3.2	9.4	11.4	13.5	14.9	10.7	10.7	10.2	12.1
Real GDP growth (in percent)	3.4	2.6	-2.2	2.8	2.5	2.8	3.1	3.1	3.2
Inflation (GDP deflator, in percent)	22.0	24.5	40.6	24.6	20.6	13.3	10.4	9.6	9.1
Nominal GDP growth (in percent)	26.0	27.8	37.5	28.3	23.4	16.5	13.9	13.0	12.6
Effective interest rate (in percent) [4/]	4.3	6.1	5.6	6.5	8.2	8.4	8.5	9.0	9.4

As of September 12, 2017		
Sovereign Spreads		
EMBIG (bp) 3/		394
5Y CDS (bp)		278
Ratings	Foreign	Local
Moody's	B3	B3
S&Ps	B	B
Fitch	B	B

Contribution to Changes in Public Debt

	Actual			Projections							
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-2.5	12.4	-1.7	-1.5	-1.2	-1.1	0.1	0.9	1.4	-1.4	
Identified debt-creating flows	0.2	9.2	-2.4	-5.3	-3.4	-1.4	-0.3	0.2	0.4	-9.7	
Primary deficit	3.4	4.1	4.3	4.2	3.2	2.2	2.1	2.0	1.9	15.5	1.6
Primary (noninterest) revenue and grants	25.4	27.2	27.1	26.4	26.1	26.0	25.9	25.8	25.8	156.1	
Primary (noninterest) expenditure	29.1	31.3	31.4	30.6	29.3	28.2	27.9	27.8	27.7	171.6	
Automatic debt dynamics [5/]	-5.3	5.1	-6.7	-9.4	-6.6	-3.6	-2.4	-1.8	-1.5	-25.2	
Interest rate/growth differential [6/]	-8.5	-7.4	-12.5	-9.4	-6.6	-3.6	-2.4	-1.8	-1.5	-25.2	
Of which: real interest rate	-7.3	-6.5	-13.4	-8.2	-5.5	-2.3	-1.0	-0.4	0.0	-17.4	
Of which: real GDP growth	-1.2	-0.9	0.9	-1.2	-1.1	-1.3	-1.4	-1.4	-1.5	-7.8	
Exchange rate depreciation [7/]	3.2	12.5	5.9	…	…	…	…	…	…	…	
Other identified debt-creating flows	-0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Government and Public Sector Finance: General Governmer	-0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euroarea loans)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	1.7	3.2	0.7	3.8	2.2	0.3	0.4	0.7	0.9	8.3	



Source: Fund staff calculations and estimates.

1/ Public sector is defined as central government.

2/ Based on available data.

3/ EMBIG.

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

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

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

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

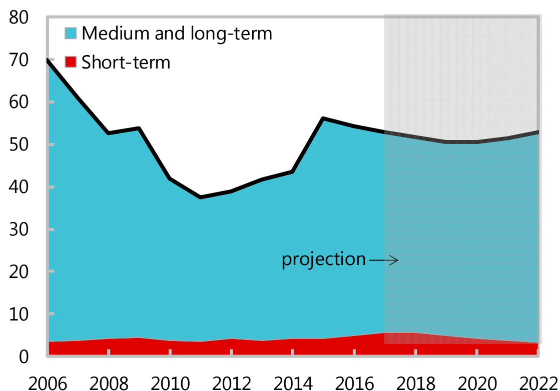
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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

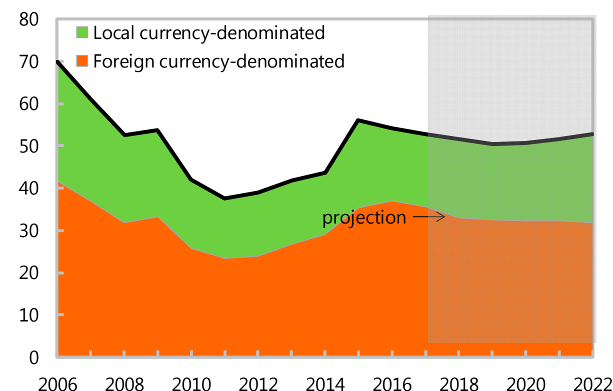
Argentina Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



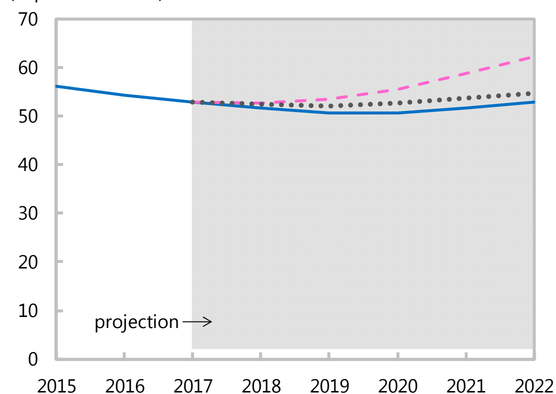
By Currency
(in percent of GDP)



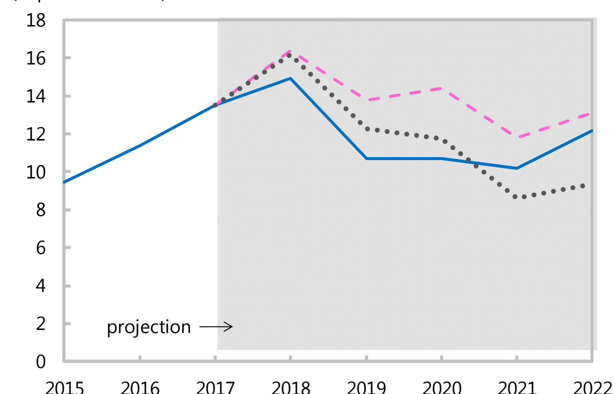
Alternative Scenarios

Baseline — Historical — Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

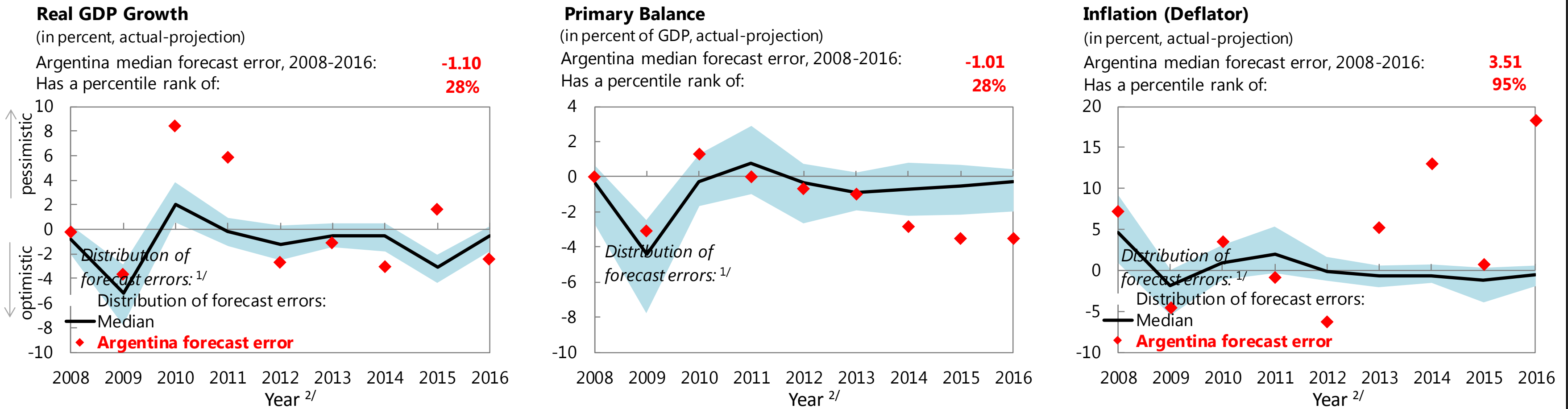
Baseline Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	2.8	2.5	2.8	3.1	3.1	3.2
Inflation	24.6	20.6	13.3	10.4	9.6	9.1
Primary Balance	-4.2	-3.2	-2.2	-2.1	-2.0	-1.9
Effective interest rate	5.9	8.2	8.4	8.5	9.0	9.4
Constant Primary Balance Scenario						
Real GDP growth	2.8	2.5	2.8	3.1	3.1	3.2
Inflation	24.6	20.6	13.3	10.4	9.6	9.1
Primary Balance	-4.2	-4.2	-4.2	-4.2	-4.2	-4.2
Effective interest rate	5.9	8.2	8.3	8.4	9.0	9.5

Historical Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	2.8	2.3	2.3	2.3	2.3	2.3
Inflation	24.6	20.6	13.3	10.4	9.6	9.1
Primary Balance	-4.2	-3.9	-3.9	-3.9	-3.9	-3.9
Effective interest rate	5.9	8.2	5.6	4.6	4.2	3.7

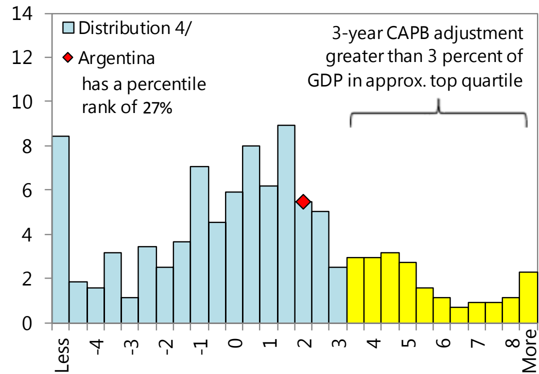
Source: Fund staff calculations and estimates.

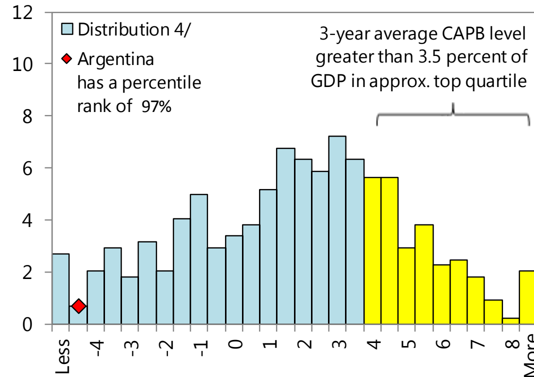
Argentina Public DSA - Realism of Baseline Assumptions

Forecast Track Record, versus surveillance countries

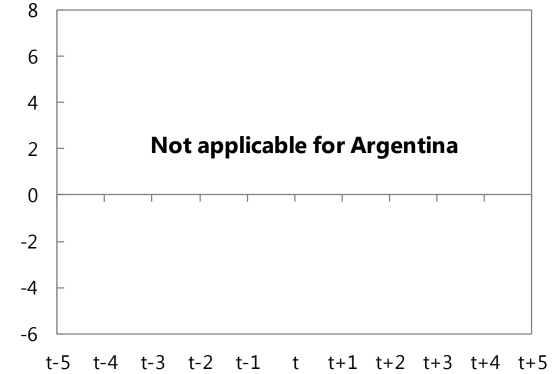


Assessing the Realism of Projected Fiscal Adjustment





Boom-Bust Analysis 3/



Source: Fund staff calculations and estimates.

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

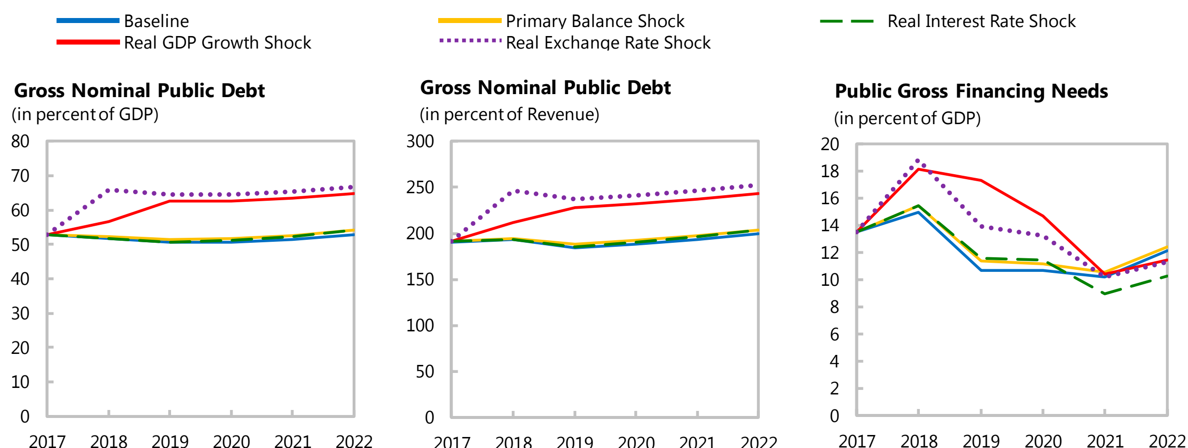
2/ Projections made in the spring WEO vintage of the preceding year.

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

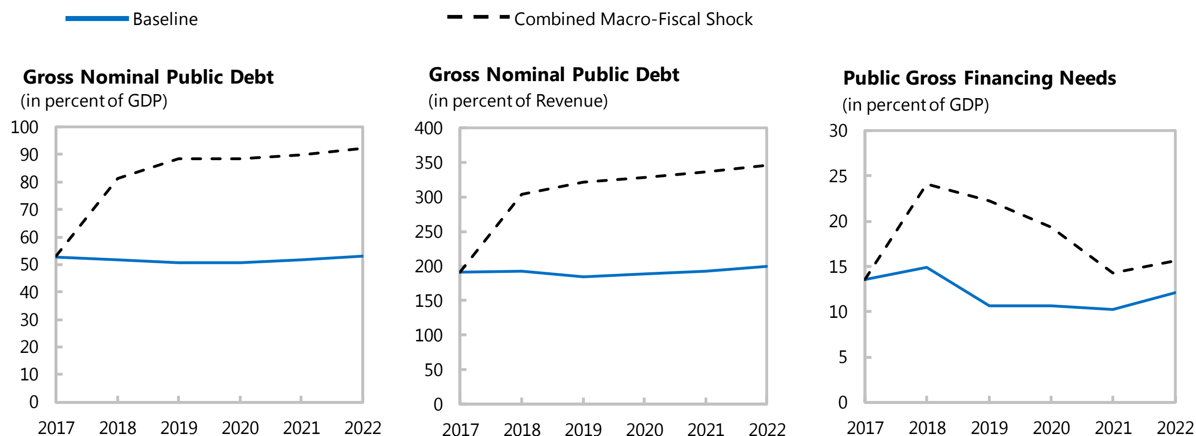
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Argentina Public DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2017	2018	2019	2020	2021	2022
Real GDP growth	2.8	2.5	2.8	3.1	3.1	3.2
Inflation	24.6	20.6	13.3	10.4	9.6	9.1
Primary balance	-4.2	-3.7	-2.7	-2.1	-2.0	-1.9
Effective interest rate	5.9	8.2	8.4	8.6	9.1	9.5
Real Interest Rate Shock						
Real GDP growth	2.8	2.5	2.8	3.1	3.1	3.2
Inflation	24.6	20.6	13.3	10.4	9.6	9.1
Primary balance	-4.2	-3.2	-2.2	-2.1	-2.0	-1.9
Effective interest rate	5.9	8.2	8.8	9.0	9.8	10.4
Combined Shock						
Real GDP growth	2.8	-2.7	-2.4	3.1	3.1	3.2
Inflation	24.6	19.2	12.0	10.4	9.6	9.1
Primary balance	-4.2	-5.1	-6.0	-2.1	-2.0	-1.9
Effective interest rate	5.9	11.0	8.4	8.7	9.5	10.1

Real GDP Growth Shock	2017	2018	2019	2020	2021	2022
Real GDP growth	2.8	-2.7	-2.4	3.1	3.1	3.2
Inflation	24.6	19.2	12.0	10.4	9.6	9.1
Primary balance	-4.2	-5.1	-6.0	-2.1	-2.0	-1.9
Effective interest rate	5.9	8.2	8.5	8.7	9.2	9.6
Real Exchange Rate Shock						
Real GDP growth	2.8	2.5	2.8	3.1	3.1	3.2
Inflation	24.6	37.9	13.3	10.4	9.6	9.1
Primary balance	-4.2	-3.2	-2.2	-2.1	-2.0	-1.9
Effective interest rate	5.9	11.0	7.9	8.0	8.5	9.0

Source: Fund staff calculations and estimates.

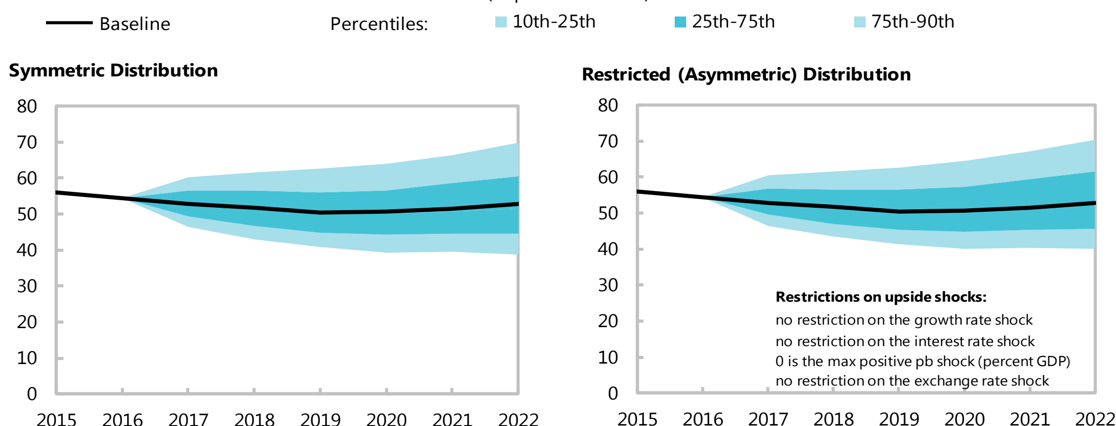
Argentina Public DSA Risk Assessment

Heat Map

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

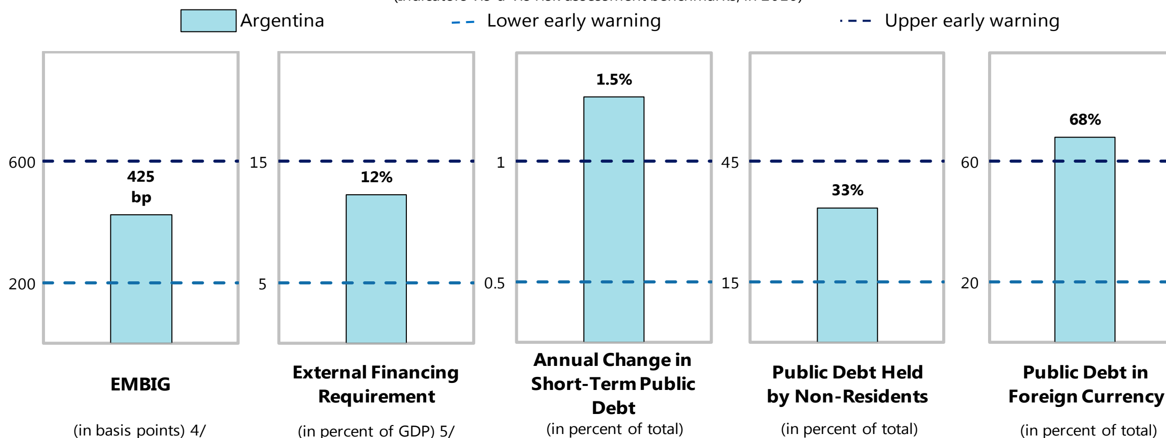
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2016)



Source: Fund staff calculations and estimates.

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

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

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

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

4/ EMBIG, an average over the last 3 months, 14-Jun-17 through 12-Sep-17.

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

Statement by the Staff Representative on the Article IV Consultation
December 18, 2017

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

Economic outlook. A few indicators suggest the economy is losing some of the momentum achieved in Q3, in line with staff forecasts. The monthly indicator of economic activity slowed to 1.2 percent (saar) in September from 2.4 percent in August. An alternative private indicator shows no seasonally adjusted growth in October. After rising rapidly through September, consumer confidence stabilized in November. Industrial indicators have been mixed, but those for construction remain robust and formal employment growth picked up in September. The trade deficit worsened further (and more than expected by staff) in October, as imports continued to accelerate (the REER appreciated 2 percent in November compared to the previous month, and is up by about 6 percent since August).

Monetary policy. Inflation expectations for end-2018 from the BCRAs' survey inched up by about 0.6 percentage points in December, and are now at 16.6 percent, close to staff forecast. This the announced adjustments in utility tariffs during the month (which led to a 45 percent average increase in gas prices and a 44 percent average increase in electricity tariffs). Wage growth of private sector employees was running at 28½ percent (y/y) in September.

Fiscal policy. The primary deficit of the federal government reached 2.5 percent of annual GDP in October, 0.8 percentage point less than the first ten months of 2016. In real terms, primary spending has fallen by about 1½ percent during this period, driven by lower energy subsidies. Tax revenue continued to grow robustly in November at 30 percent (y/y) (excluding one-off revenues from the tax amnesty late last year). This suggests that the federal government may close 2017 with a better-than-targeted primary fiscal deficit, although authorities could also decide to bring forward some of next year's spending to facilitate reaching the (more ambitious) 2018 target.

FX reserves and Debt issuances. International reserves reached US$55 billion in December, mainly reflecting public debt placements. The province of Rio Negro made its first global issuance in early December, becoming the 14th province to issue in international markets since the holdout settlement in April 2016. Moody's upgraded Argentina's rating to B2 from B3, with stable outlook, citing the improved prospects for reforms.

Legislative progress. The Senate approved and sent to the lower house the fiscal pact, fiscal responsibility, and pension indexation reform laws, while the labor market reform bill is still under discussion. The approved indexation formula would update pensions by a weighted average of consumer prices (0.7) and wages (0.3) each quarter, instead of solely on the CPI. The tax reform and asset recovery bills are being discussed in the lower house. In turn, the lower house has approved the competition and capital markets laws, and sent them back to the Senate. The government has called for extraordinary sessions of Congress in late December to seek approval of many of these bills and of the 2018 Budget.

Statement by Mr. Lopetegui, Alternate Executive Director on Argentina
December 18, 2017

Background. Since taking office two years ago, Argentina's new administration has made considerable progress in implementing its ambitious policy agenda. Efforts have been focused on establishing sound macroeconomic policies, restoring credibility, and laying the groundwork for inclusive, balanced, and sustainable growth. Price, currency, and trade controls were removed. Restrictions in the foreign-exchange market were lifted, taxes on exports were essentially eliminated, long-standing disputes with private foreign creditors were settled and subsidies in the provision of public services were reduced. Fiscal targets have been set and the central bank adopted an inflation-targeting regime. In parallel, the government put in place an immediate plan to rebuild the official statistics office (INDEC) which recovered its credibility.

These decisive actions are paying off.

Economic activity has been expanding since the second half of 2016 and growth is set to reach close to 3 percent in 2017. The recession that began in the last part of 2015 ended in Q2 2016 and was the mildest in terms of output loss of the recent recessions suffered by Argentina. Up to the second quarter of this year, growth was 2.7 percent year-on-year, and has been led by investment (7.7 percent year-on-year) and private consumption (3.8 percent). The labor market has improved as well, reacting to the increase in output. The unemployment rate declined to 8.7 percent of the labor force in the second quarter of 2017 (from 9.3 percent in the same quarter last year), with more than 200,000 new jobs created. Meanwhile, real wages have increased and the poverty rate decreased to 28.6 percent, from 32.2 percent in the first half of 2016.

Inflation is on a clear downward trend. Inflation has been very high for many years, with peaks up to about 40 percent. It will finish 2017 below 25 percent, more than 10 percentage points below that of 2016.

The size of public spending and the primary deficit are declining. Execution of fiscal policy this year is on target, with a real increase in tax collections and a reduction of primary expenditure in terms of GDP. Between 2015 and 2017, consolidated primary spending of the general government—including provinces—would decline by 2 points of GDP. Utility tariffs are increasing to be aligned with production costs and subsidies have been reduced (by 23 percent in nominal terms during the first 10 months of 2017) and oriented towards those in need. The improvement in macroeconomic conditions was reflected in the credit rating of Argentina's sovereign debt which was upgraded twice by Moody's and three times by S&P during the last two years. In line with rating upgrades, the cost of public debt continues declining and is at historical lows.

While the current account remains negative, this is mainly reflecting the strong rebound of investment. Imports of capital goods explain a large share of the trade deficit. Meanwhile, the central bank has built reserves accommodating strong capital inflows. Reserves increased to more than US$ 54 billion, close to 10 percent of GDP and about 10 months of imports.

Banks remain strong with adequate levels of capital and liquidity. Domestic credit availability is increasing, with total bank credit to the private sector growing above 20 percent in real terms over the last 12 months, amid a decline in interest rates, particularly for mortgages, which are at historical lows. The implementation of indexation of long-term loans (mortgages) was a key factor in explaining the decrease in interest rates

Strong social policies remain in place. Income transfer programs continue to be an essential tool for combating poverty, ensuring a minimum income for those who need it most. The Universal Child Allowance is an ongoing program that has been enlarged and enhanced reaching 3.9 million children (7 percent more than in 2015). Moreover, 4.2 million children were reached by the Family Income Policy framework, of which 1.2 million were incorporated in 2017. The National Plan for Early Childhood was launched at the beginning of 2016 to eradicate malnutrition in children under the age of four. In education, the public system has, for the first time, covered all children over the age of three, benefiting more than 638,000 children. Public pensions have been increased through legislation that brought pensions to the levels mandated by law, which were not met by previous administrations. This adjustment will reduce litigation by beneficiaries and contingent liabilities of the public sector.

The top medium-term government priorities.

Building on this success, the authorities continue addressing the top medium-term government priorities. Higher levels of investment are needed to sustain rapid growth and employment to sustainably reduce poverty, the overarching objective of the administration. The economy is expected to grow by 3.5 percent in 2018, a rate among the highest in Latin America. The goal over the medium-term is to maintain this level, supported by lower taxes and productivity-enhancing reforms. At the same time, the government is strongly committed to strengthening institutions and modernizing the state, enhancing the social safety net, and ensuring that social expenditures and public services reach the poorest sectors of society. Following October's mid-term elections, which resulted in strong support for the administration, President Macri has launched a number of initiatives to address structural problems. These initiatives can be grouped in three main areas: fiscal responsibility and tax reduction; employment generation; and institutional strengthening.

Fiscal responsibility and tax reduction.

The authorities are addressing long-standing issues that have affected public finances and continue to move forward with the objective of reducing the size of the State in the economy,

to allow for a decline in the tax burden and a reduction of the deficit of the public sector. A political agreement with provinces has been reached to pass legislation by end-2017 on fiscal responsibility, a fiscal pact, a tax reform, and a social safety net reform. The laws implementing this agreement, described below, are expected to be approved by Congress before year-end.

Fiscal responsibility law. The draft law includes limits to the growth of public spending at the national and subnational levels, with the objective of maintaining real expenditures constant, ensuring a decline in terms of GDP. Importantly, all jurisdictions commit to avoiding an increase of public employment above population growth.

Fiscal pact with subnational governments. Revenue-sharing agreements between the federal and provincial governments have been historically contentious. There are important asymmetries in the distribution of revenue vis-à-vis the economic size of provinces, notably against the province of Buenos Aires, and most jurisdictions have raised constitutional challenges to laws establishing revenue-sharing agreements. As a result, there is a large number of lawsuits pending resolution by the Supreme Court of Justice, with contingent liabilities for the federal government of up to 7 percent of GDP. Congress is considering a law that will rebalance revenue-distribution and most importantly, will result in most provinces dropping the judicial claims against the federal government.

Tax reform. Tax reform aims at reducing the overall tax burden and the most distortive taxes, providing incentives to investment and employment, and adding progressivity to the overall taxation of wage income. The reform now in Congress will further reduce taxes by 1.5 percent of GDP over a period of five years. Key features include: (i) reducing the corporate income tax rate from 35 to 20 percent when profits are reinvested, (ii) accelerated refunds of VAT credits on investment, (iii) elimination of employers' social security contributions for workers earning less than AR$12,000 (approx. US$685) per month, while eliminating the cap on social security contributions for wages above AR$82,000 (approx. US$4,685) per month, (iv) crediting the financial transaction tax against the corporate income tax, (v) rebalancing excise and fuel taxes, and (vi) taxing individuals' financial income. To address problems generated by the lack of inflation adjustment of businesses' income statements on their tax liabilities, a one-off adjustment in the value of corporate assets will be allowed on a voluntary basis, at a cost of 5 percent of such revaluation. In the context of the fiscal pact with subnational governments, provinces are committing to gradually reduce their most distortive taxes over time—mostly *Ingresos Brutos*, a turnover tax creating cascading effects, and the stamp tax.

Reducing and focalizing subsidies. While domestic oil prices already reflect international parities, utility rates remain below cost. The authorities will adjust electricity, gas, and transport rates, aiming at achieving cost-recovery ratios between 80-90 percent by end 2018 and near 100 percent in 2019. Social tariffs for electricity and gas will remain in place to protect lower income households.

Social safety net reform. Social transfers (pensions, family allowances, universal child allowance) have been indexed in the recent past using a formula combining the growth of tax revenue and salaries, in the absence of reliable inflation data. This adjustment led to distortions. Keeping the objective of at least maintaining the real value of these transfers, a new formula for quarterly indexation will be enacted reflecting inflation (70 percent) and salary growth (30 percent). A fundamental analysis of the pension system and a proposal for reform—addressing sustainability and equity considerations—are expected to be concluded in a couple of years.

Tax administration. The high legal tax burden has resulted in elevated levels of tax evasion and informality. While the tax reform will help address these, the tax administration office (AFIP) continues to make important progress in the fight against tax evasion, with improvements in the administration of taxpayers' debts, better compliance indicators in key sectors, and enhanced control of electronic invoices. The automatic exchange of information with foreign jurisdictions, as agreed by OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes, has started.

Fiscal projections. As a result of this comprehensive approach, the authorities expect consolidated public spending to decline from 41 percent of GDP in 2017 to 33 percent of GDP in 2023 (assuming the economy grows at 3.5 percent per year). For the federal government, the primary deficit will decline to 3.2 percent of GDP in 2018, with primary spending falling to 22 percent of GDP. The debt of the federal government with the private sector and international organizations will increase to 31 percent of GDP in 2018, among the lowest in the region, and is expected to stabilize at 37 percent of GDP by 2020. Provinces are expected to achieve a primary balance in 2018—from a deficit of 0.5 percent of GDP in 2017—and will use the fiscal space gained over time with the operation of the fiscal responsibility law and the fiscal pact to reduce distortive taxes. According to the authorities' projections, the total tax burden (federal and provincial) will decline by 3 points of GDP in the next five years, totaling a decline of five points of GDP since 2015.

Reducing inflation. In the monetary area, the central bank will continue operating an inflation-targeting regime, with the objective of reducing inflation to 5 percent over the medium term. Given still high inflation, monetary policy is expected to maintain its contractionary stance through high real policy interest rates.

Employment generation.

The second area of the strategy is to spur employment creation in the formal economy, the only sustainable way to inclusion and poverty reduction.

Labor reform. The main measures under discussion include a mechanism to formalize employment relations, reduce the tax wedge on low-income earners (via the announced tax reform), reduce litigation related to labor relations, and expand on-the-job training. To reduce

conflicts related to accidents in the workplace, a new law has already been enacted clarifying the framework, to which provinces are expected to gradually adhere.

Expanding access to credit. The authorities are working towards developing domestic capital markets to finance development. The new capital markets law, expected to be approved before year-end, seeks to give strong support to SME financing; increase investor protection; facilitate public offerings of stocks; spur development of the mortgage market and financial inclusion; promote long-term savings; strengthen the infrastructure of capital markets; and improve the independence and oversight capacity of the supervisor (*Comisión Nacional de Valores*). In parallel, the central bank will work towards maintaining financial stability and pursuing the sound expansion of the financial sector, promoting the use of local-currency saving instruments to finance credit expansion in local-currency at longer maturities and lower rates. In this context, priorities include increasing access to bank services by all segments of society and promoting the use of electronic payments, contributing to the formalization of economic activity.

Modernization of the State. Administrative simplification will help reduce the regulatory burden of the State on the private sector and increase productivity. The main elements of this program include the elimination of redundant requirements for businesses to operate, the possibility of filling these requirements online, the unification of registries across public offices, and the implementation of e-files in the public sector. Online procurement systems have been launched to increase transparency and competition. Procedures for setting up small businesses have been streamlined and it is now possible to register a business in 24 hours. To facilitate international trade, a one-stop online system is being built and currently 80 percent of export and import requirements can be filled online. A plan geared towards setting optimal personnel allocations in the public sector is ongoing, which will serve as a benchmark for rationalizing public employment while maintaining high-quality service.

Rebuilding infrastructure. While much progress has been achieved with better prioritization and efficiency of investment projects undertaken by the public sector, infrastructure needs remain very high. The new law for public-private partnerships approved in 2016 allows for new investment carried out by the private sector with limited fiscal risks and high transparency standards. About 60 projects have been identified (in transport; energy; communications and technology; water, sewage and housing; and health, justice, and education) and included in the 2018 budget to be undertaken under PPPs, resulting in additional investment of about 1 percent of GDP per year in the next three years. Successive budget laws will include clear information about the degree of advance of each project and the fiscal impact through public spending commitments and public guarantees.

Institutional strengthening.

The third area of the strategy consists of passing reforms to improve the functioning of the justice system, the electoral system, and prevent and punish corruption. Since December

2015, the administration has focused on implementing anticorruption policies and promoting integrity and transparency in public administration. Transparency will increase with the implementation of the new law of Access to Public Information enacted in 2016. The new Repentant law reduces sanctions to individuals that provide information contributing to avoiding a crime or clarifying facts under investigation. A law is under discussion in Congress to punish private corporations for corruption offenses and make anticorruption policies more effective. At the same time, the executive power has issued decrees clarifying disclosure rules to avoid conflicts of interest in economic relations with the public sector and strengthened financial disclosure of public sector officials.

Concluding remarks.

I hope that with these remarks I have been able to transmit to the Executive Board the fundamental policy change taking place in Argentina. The transit to sustainable macroeconomic policies is being implemented while avoiding any major macroeconomic crisis, so prevalent in Argentina's history. Continued action is necessary. In the words of President Macri, these are the times of *permanent reform*, to unleash private sector initiative and sustain development. Argentina has embarked on a transformation to fully integrate into the global economy. While not without risks, the strategy is solid and it is homegrown.

I would like to thank IMF staff for their contributions to policy discussion and the work done during this consultation. Some of the tensions identified by staff are indeed present. Nevertheless, it is the view of the authorities that a faster pace of deficit reduction would put the economic recovery and social cohesion at risk. In the current juncture, the overall level of taxation can only go down, and any significant cut in the wage bill or social transfers, in the order of magnitude and with the timing suggested by staff, would have a large impact on domestic demand and growth. The authorities also believe that staff has overestimated the revenue loss associated with the tax reform. This said, the authorities remain open to considering an acceleration of the pace of fiscal consolidation should upside risks to growth materialize. The stance of monetary policy will continue aiming at achieving a gradual reduction in the inflation rate.

My authorities want to emphasize that their fiscal strategy would lead to a sustained decline in the public debt ratio. Staff assumes that the fiscal position measured by the primary balance remains at a deficit of broadly 2 percent of GDP beyond 2019, while the authorities' objective is to continue with the 1-percent-of-GDP annual reduction of the primary deficit until a primary surplus is achieved (the authorities' DSA can be found in the draft budget law for 2018 submitted to Congress). In addition, the authorities expect medium-term growth to stand at 3.5 percent of GDP compared to about 3 percent assumed by staff.

The increase in the external current account deficit calls for vigilance, but is also the natural result of years of financial autarky, as revealed by a positive NIIP, which contrasts with the level that could be expected for a country at Argentina's stage of development. Exports

should improve in the face of better regional growth prospects, notably in Brazil. The authorities are confident that their economic strategy will yield important productivity gains and improve the external balance. One example is the energy sector. Staff rightly notes that, at present, higher oil prices constitute a negative terms-of-trade shock (staff report, Annex I, paragraph 1). This should not hold for long. For many years, Argentina was a net energy exporter and has the resources to return to that position (in the last five years to 2016, the energy trade balance averaged a deficit of 0.8 percent of GDP, which compares with a surplus of 2 percent of GDP in the preceding decade). It only needs time for the right incentives, which are being set in place, to affect supply and demand.