

I. ECONOMIC ENVIRONMENT

(1) OVERVIEW

1. Since its last Trade Policy Review in 1999, Argentina has succeeded in overcoming one of the worst recessions in its history, with GDP contracting by some 18.5 per cent between 1998 and 2002. This contraction was attributable to a series of factors, both internal and external, such as the accumulation of public debt and the loss of external competitiveness resulting from the real overvaluation of the peso. The financial crisis which broke out in 2001 led to a moratorium on public debt payments, the abandonment of the system of convertibility and a sharp fall in the exchange rate, as well as to increases in inflation and unemployment.

2. In response to the crisis, Argentina introduced a programme of macroeconomic adjustment and support for the financial system. In December 2001, it halted the repayment of principal and interest on its debt, a suspension which continued for more than three years. At the beginning of 2005, the Argentine authorities succeeded in refinancing over 76 per cent (US\$62 billion) of the public debt, on very favourable terms, by exchanging old claims for three new types of bonds, at 32 centavos to the US dollar. It has not yet reached an agreement with the creditors who hold the other 24 per cent of the debt (some US\$20 billion). In early 2006, the Government paid off the entire IMF debt of US\$9.6 billion. This reduced the debt/GDP ratio to below 65 per cent.

3. Since 2003, the Argentine economy has returned to the path of growth, with GDP increasing at rates of more than 9 per cent. The strongest boost has come from increased domestic demand, although exports, which have benefited from a favourable international environment and the depreciation of the exchange rate, have also contributed to the recovery. The fiscal accounts have been in surplus since 2003, mainly owing to an increase in revenue resulting, in part, from improved receipts from export duties, which are now being applied at higher rates to a wider range of products. In the 12 months to September 2006, inflation, measured in terms of the increase in consumer prices, reached 11 per cent, so that holding down inflation on an ongoing basis remains the Government's chief macroeconomic concern. With the resumption of growth, unemployment began to fall and in the second quarter of 2006 was down to about 10.2 per cent, while the percentage of the population living below the poverty line had fallen to 33.8 per cent in 2005.

4. The current account of the balance of payments has been in substantial surplus since 2002. This is mainly the result of increased exports, lower import levels during the post-crisis period, although they have since been recovering, and reduced debt payments. One of the most striking features of the period under review is the reorientation of exports towards countries outside MERCOSUR. Argentina, a large exporter of agricultural products and, increasingly, of manufactured products, could benefit considerably from a favourable outcome of the Doha Development Round.

5. The Government intends to continue implementing policies designed to keep public finances and the current account of the balance of payments in surplus, to create more jobs and to bring inflation under control. To help them achieve their macroeconomic objectives, the authorities have made use of trade measures, such as the application of export taxes, incomes policies and price agreements with producers to prevent or moderate price increases (see Chapter III); some of these measures were adopted under the powers temporarily granted to the Executive by the Public Emergency and Exchange Regime Reform Law (see Chapter II). The authorities have stressed the fact that these are temporary measures.

6. Although the results achieved since 2003 have been remarkable, there are risks with regard to the sustainability of the present model and the possibility of a "soft landing" for the economy. The

main risk comes from overheating and the distortions created by the unorthodox economic measures adopted in recent years. In particular, it would be important to implement a strategy that allowed free rein to market forces in the allocation of resources and the determination of prices.

(2) MACROECONOMIC TRENDS

(i) Structure and evolution of the economy

7. The sectoral composition of the Argentine economy fluctuated considerably during the review period, reflecting the impact of the economic crisis on the various sectors and their subsequent adjustment to the new thrust of economic policy and the changes in the international environment. In the primary sectors growth was above-average (Table I.1). Progress in the agricultural sector largely reflected an improved supply and a favourable international business climate, which translated into high international prices for Argentine exports. There was also an increase in the contribution of manufactured products to GDP, largely attributable to the growth of the domestic market in recent years, and a sharp decline in the contribution of non-tradeable activities, although there have recently been signs of a recovery in this respect. Services as a whole continue to generate a little over 55 per cent of GDP; after a sudden fall, due partly to the change in relative prices, services have slowly begun recovering their share of GDP.

Table I.1
Sectoral structure of GDP, 1998-2005
(Percentage of current GDP at factor cost, including imputed bank service charges)

	1998	1999	2000	2001	2002	2003	2004	2005	2006 ^a
GDP									
Agriculture (including forestry)	5.5	4.6	4.8	4.6	10.3	10.6	10.2	9.2	7.0
Fishing	0.2	0.2	0.2	0.3	0.5	0.4	0.3	0.3	0.4
Mining and quarrying	1.6	1.8	2.7	2.7	6.3	5.8	5.7	5.9	6.2
Primary sector	7.3	6.6	7.7	7.5	17.2	16.9	16.2	15.3	13.6
Manufacturing	19.4	18.3	17.8	17.2	21.6	24.0	24.2	23.3	23.1
Electricity, gas and water	2.1	2.3	2.5	2.5	1.8	1.7	1.7	1.7	1.9
Construction	6.0	5.9	5.1	4.6	2.7	3.3	4.2	4.9	5.2
Secondary sector	27.5	26.5	25.4	24.3	26.1	29.1	30.1	30.0	30.2
Trade	15.2	14.3	13.7	13.1	11.4	11.7	11.8	11.8	11.2
Restaurants and hotels	3.0	3.0	3.0	2.9	2.3	2.3	2.4	2.6	3.4
Transport, storage and communications	8.9	8.9	9.2	9.1	7.8	8.5	9.1	9.0	10.0
Financial intermediation	4.0	4.4	4.4	5.5	5.6	3.9	4.1	4.4	4.9
Real estate, rentals and business services	16.4	17.0	16.9	17.0	13.5	12.0	11.2	10.9	11.6
Public services and defence	6.1	6.7	6.8	6.8	5.7	5.4	5.2	5.5	5.7
Education, social and health services	8.0	8.8	9.1	9.6	7.7	6.9	6.6	7.0	6.9
Other services activities	5.2	5.4	5.5	5.7	4.0	3.8	3.9	4.1	3.8
Services	66.8	68.6	68.5	69.7	58.1	54.6	54.2	55.3	57.0
Less imputed financial services	1.6	1.7	1.6	1.6	1.3	0.5	0.5	0.6	0.8
GDP at factor cost	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

a First quarter.

Source: Ministry of the Economy and Production, <http://www.mecon.gov.ar/download/infoeco/apendice1.xls>.

8. Argentina experienced a severe recession during the period 1999-2002 (it began in the course of 1998), followed by a period of solid growth starting in 2003 (Table I.2). GDP grew at an annual average rate of 0.4 per cent between 1998 and 2005, mainly as a result of the sharp economic downturn during the years 1999 to 2002. However, the subsequent recovery and stabilization of the economy led to the achievement of growth rates of the order of 9 per cent a year.

Table I.2
Basic economic indicators, 1998-2005

	1998	1999	2000	2001	2002	2003	2004	2005	2006	
									I ^a	II ^b
Current GDP (Arg\$ billion)	298.9	283.5	284.2	268.7	312.6	375.9	447.6	532.3	568.8	676.0
Current GDP (US\$ billion)	298.9	283.5	284.2	268.7	102.0	129.6	153.2	193.2	185.9	211.0
Real GDP and components, growth rates (%)										
Real GDP	3.9	-3.4	-0.8	-4.4	-10.9	8.8	9.0	9.2	8.8	7.9
Total consumption	3.5	-1.3	-0.5	-5.2	-12.9	7.0	8.3	8.5	8.4	7.9
Private	3.5	-2.0	-0.7	-5.7	-14.4	8.2	9.5	8.9	8.4	8.2
Government	3.4	2.6	0.6	-2.1	-5.1	1.5	2.7	6.2	8.3	6.5
Gross fixed capital formation	6.5	-12.6	-6.8	-15.7	-36.4	38.2	34.4	22.7	22.9	18.5
Changes in inventory plus statistical discrepancy	-22.9	117.6	-350.9	148.5	-54.3	81.4	-44.9	-274.8	..	..
Exports of goods and services	10.6	-1.3	2.7	2.7	3.1	6.0	8.1	13.8	6.4	3.1
Imports of goods and services	8.4	-11.3	-0.2	-13.9	-50.1	37.6	8.1	20.3	17.8	6.3
Real GDP, percentage breakdown (%)										
Final consumption	81.6	83.8	83.1	83.1	74.1	74.6	73.9	73.2	73.8	77.1
Private	69.1	70.1	69.3	68.9	61.9	63.2	62.8	61.3	61.8	65.1
Government	12.5	13.7	13.8	14.2	12.2	11.4	11.1	11.9	12.0	12.0
Gross capital formation	19.9	18.0	16.2	14.2	12.0	15.1	19.2	21.5	21.5	20.9
Changes in inventory	1.1	-0.1	1.3	1.4	-1.0	-0.5	-0.2	-0.3	..	..
Exports of goods and services	10.4	9.8	10.9	11.5	27.7	25.0	25.3	24.6	23.8	13.4
Imports of goods and services	12.9	11.5	11.5	10.2	12.8	14.2	18.2	19.1	19.1	11.1
Other economic indicators (% GDP)										
Gross national savings	16.1	13.6	14.4	14.2	20.1	19.7	20.6	24.6 ^c	..	..
Gross domestic savings	21.0	17.9	17.5	15.6	11.0	14.6	19.0	21.3 ^c	..	..
Employment indicators										
Labour force participation rate ^d	42.1	42.7	42.7	42.2	42.9	45.7	46.2	46.2	46.0	46.7
Unemployment rate ^d	12.4	13.8	14.7	18.3	17.8	14.5	12.1	10.1	11.4	10.4
Underemployment rate ^d	13.6	14.3	14.6	16.3	19.9	16.3	15.2	13.0	11.0	12.0
Nominal wages (private sector) ^e	..	..	..	..	16.9	15.8	11.0	21.9	21.0	..

.. Not available.

a First quarter.

b Second quarter.

c First nine months; growth rate compared with the same period in the previous year.

d Calculation method changed in 2003.

e Variation of the wage index (December-December) corresponding to the registered private sector.

Note: Domestic savings include the balance on current account of the balance of payments (external savings). If there is a deficit, domestic savings exceed national savings, since the country is importing capital.

Source: Central Bank of the Argentine Republic and Ministry of the Economy and Production.

9. The downturn that began in mid-1998 largely reflected a loss of external competitiveness resulting from the real overvaluation of the peso and aggravated by adverse external factors such as the devaluation of the real in Brazil in 1999. In March 2000, Argentina turned to the International Monetary Fund (IMF) and received a US\$7.2 billion stand-by loan, later increased to 14 billion, as part of a package, including contributions from other multilateral organizations and private banks, that totalled 39.7 billion.

10. The economic recession was made worse by a financial crisis at the end of 2001 (see Chapter IV(6)(iii)). In response to this crisis, characterized by severe capital flight, the Government announced restrictions on withdrawals from bank accounts (*corralito*). Decree No. 1.570/01 of 1 December 2001 imposed temporary restrictions on withdrawals of cash, which were limited to

US\$250 a week, and temporarily prohibited transfers abroad, except for those corresponding to foreign trade transactions, payments of expenses or withdrawals made abroad using credit or debit cards, or the cancellation of financial transactions.¹ There was also a moratorium on the repayment of public debt. This formed the prelude to the abandonment of the convertibility regime (see below). The IMF takes the view that the crisis was mainly triggered by a combination of two factors: an insufficiently tight fiscal policy and an overvalued exchange rate, the reflection of relatively high inflation,² a strong dollar and insufficiently flexible domestic markets, especially the labour market.³

11. Law No. 25.561 of 6 January 2002 repealed the fixed exchange rate regime and declared a state of social, economic, administrative, financial and foreign-exchange emergency, to deal with which it delegated extraordinary powers to the Executive.⁴ Moreover, the foreign currency adjustment clauses and indexation clauses in contracts governed by public law were annulled. Prices and tariffs were established in pesos at the exchange rate of Arg\$1 to the US dollar, and the Executive was authorized to renegotiate these contracts.

12. In February 2002, the maturity of time deposits was extended (measure known as *corralón*) and bank deposits and assets were converted into pesos at asymmetric rates of Arg\$1 to the US dollar for assets and Arg\$1.4 for liabilities.⁵ This measure gave rise to a series of legal actions (*amparos*) brought by depositors demanding compensation from the banks for the losses incurred as a result of pesoization. The IMF estimates that the injunctions granted in these cases cost the banks a total of Arg\$8.8 billion between February 2002 and mid-2005.

13. In January 2003, the IMF approved the first of a series of temporary eight-month stand-by loans for Argentina equivalent to US\$2.98 billion.⁶ In this connection, the Argentine authorities have pointed out that, previously, during the 2001/2002 crisis period, net payments amounting to approximately US\$15 billion were made to the multilateral credit organizations (of which 9 billion went to the IMF). In September 2003, the IMF approved a new three-year stand-by loan equivalent to US\$12.55 billion, as well as an extension of the payment period for debts amounting to US\$2.43 billion.⁷ In December 2005, Argentina announced the repayment of all its debt to the IMF.⁸

¹ The complete and up-to-date text of the Decree is available at: <http://infoleg.mecon.gov.ar/infolegInternet/anexos/70000-74999/70355/texact.htm>.

² During the initial period of application of the Convertibility Plan, the divergence between the domestic inflation rate and the inflation rate in the United States contributed to a rapid real appreciation of the peso. Cumulative inflation between 1991 and 1995 was 145 per cent, primarily as a result of the inflation that built up in the first half of 1991. As of 1995, inflation fell to very low levels, and from 1999 to 2001 there was deflation.

³ In her analysis of the Argentine crisis, Anne Krueger, former First Deputy Executive Director of the IMF, personally responsible for supervising the IMF's negotiations with Argentina during the crisis, notes that the lack of flexibility was especially significant since under a fixed exchange rate regime other sources of adjustment are needed to maintain competitiveness. Krueger recognizes that the IMF should have insisted more on fiscal austerity, but says that the choice of the exchange rate to apply is a sovereign decision for each country to make (Krueger, Anne (2002)). For a critical analysis of the IMF's position prior to the Argentine crisis see Nielsen, Guillermo (2006), pp. 64-71.

⁴ The state of public emergency was initially declared for the period up to 31 December 2004; Law No. 25.972 of 17 December 2004 and Law No. 26.077 of 10 January 2006 were extended until 31 December 2005 and 31 December 2006, respectively.

⁵ Decree No. 214/02 (Pesoization) of 3 February 2002 and updates: Decrees Nos. 320/02 of 15 February 2002 and 410/02 of 1 March 2002, and Law No. 25.642 of 11 September 2002.

⁶ IMF (2003a).

⁷ IMF (2003b).

⁸ IMF (2005b).

14. In 2003, Argentina began emerging from the recession. GDP grew at a rate of 9 per cent in 2004 and 9.2 per cent in 2005. Domestic demand made a negative contribution to the growth of GDP during the period 1999-2002, with a sharp contraction in private consumption and an even more rapid decline in investment (Table I.2). Domestic demand was mainly affected by the severe fall in income that followed the depreciation of the peso, as well as by high interest rates and a domestic credit crunch. From 2003 onwards, domestic demand steadily recovered. The behaviour of investment, which outstripped the rate of growth of GDP, was particularly dynamic. The private investment rate recovered and even surpassed its pre-crisis levels, reaching 21.5 per cent of GDP in 2005.

15. The unemployment index rose considerably between 1998 and 2002, when it stood at more than 18 per cent. Since then, with the return of growth, employment has risen, and the unemployment rate fell to 10.2 per cent in the second quarter of 2006. According to the authorities, the employment rate in 2006 was the highest in recent years. Real wages fell during the crisis period, with nominal wages increasing by less than inflation; in the private sector the fall in real wages ended in 2003. However, public sector wages continued falling in real terms until 2005.

16. The 1998-2002 recession resulted in a general deterioration in well-being: per capita GDP shrank considerably in terms of its US dollar value between 1998 and 2002, after which it rebounded. The financial crisis of 2001-2002 led to a considerable worsening of the social indicators which, however, have improved significantly with the economic recovery and with the implementation of employment promotion and other income policies; the percentage of the population living below the poverty line fell from 57 per cent in 2002 to 33.8 per cent in 2005. According to the authorities, the alleviation of poverty is the Government's first priority.

(ii) Fiscal policy

17. The Ministry of the Economy and Production (MEP) is responsible for formulating and implementing fiscal policy in Argentina. The objective of fiscal policy is to establish a sustainable situation of fiscal solvency as a basis for stable and equitable growth.⁹ According to the national budget for 2006, fiscal policy should help to achieve a primary surplus of 3.3 per cent of GDP for the non-financial public sector, through increased revenue collection and the selective allocation of primary expenditure, with priority for social programmes and expenditure on education, science and technology, and infrastructure.¹⁰

18. The fiscal situation deteriorated considerably between 1998 and 2001, mainly because of a fall in revenue attributable to reduced levels of activity and increased interest payments on federal and provincial debt. The accounts for the non-financial public sector were in deficit between 1998 and 2002 (Table I.3). To remedy this situation, between 2000 and 2001 a contractionary fiscal policy was maintained. In 2001, the Law on Fiscal Balance (Zero Deficit) (*Ley de Equilibrio Fiscal (Déficit Zero)*) (Law No. 25.453 of 30 July 2001) was introduced. This stipulated that the total appropriations for a fiscal year could not exceed the revenue collected during the same year, and that if the estimated budget funds were not sufficient to cover all the proposed appropriations, the appropriations, including those for paying salaries, would be reduced proportionately.

19. The fiscal situation began to improve in 2003, with the trend strengthening in 2004 and 2005, due partly to lower interest payments but mainly to a substantial increase in revenue as a result of the rebound in the economy. Some of the additional revenue could be attributed to indirect taxes. Thus, in 2005, tariffs represented 0.8 per cent of GDP and export duties 2.5 per cent. However, there was

⁹ Decree No. 8 Promulgating Law No. 26.078 (General Budget 2006) of 9 January 2006. Consulted at: <http://www.mecon.gov.ar/onp/html/ley-2006/ley/veto.htm>.

¹⁰ Budget 2006. Consulted at: <http://www.mecon.gov.ar/onp/html/ley-2006/ley/ley2006.pdf>.

also an increase in direct taxes, due to the growth of production and employment. In 2005 and 2006, the authorities implemented an expansionary fiscal policy, while maintaining certain levels of fiscal surplus, which, according to the authorities, is a basic feature of the economic policy in force. The IMF calculates that the thrust of fiscal policy was contractionary in 2003 and 2004, but expansionary in 2005.¹¹

Table I.3
Non-financial public sector financial accounts, fiscal years 1998-2006
(Percentage of GDP and US\$)

	1998	1999	2000	2001	2002	2003	2004	2005	2006 ^a
(1) Current revenues	18.7	19.3	19.4	18.7	17.6	20.5	23.4	23.7	23.8
A. Tax revenue	13.5	13.6	14.3	13.8	12.8	16.2	18.7	19.2	18.5
B. Social security contributions	4.0	3.8	3.8	3.6	3.1	3.1	3.3	3.5	4.3
C. Non-tax revenue	0.7	1.2	0.7	0.8	0.9	0.9	1.0	0.7	0.5
D. Other revenue	0.6	0.6	0.6	0.6	0.8	0.4	0.5	0.3	0.5
(2) Current expenditures	19.0	20.8	20.9	21.0	18.4	19.2	19.6	20.1	19.1
A. Consumption and operating expenditure	3.1	3.3	3.0	3.1	2.9	3.1	2.9	3.0	3.1
Wages	2.3	2.5	2.4	2.4	2.2	2.3	2.1	2.1	2.3
Goods and services	0.8	0.8	0.7	0.7	0.7	0.8	0.8	0.9	0.8
B. Property income	2.2	2.9	3.4	3.8	2.2	1.8	1.3	1.9	1.9
Interest	2.2	2.9	3.4	3.8	2.2	1.8	1.3	1.9	1.9
Other income	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
C. Social security benefits	5.8	6.1	6.1	6.2	5.3	5.2	5.1	4.6	4.4
D. Other current expenditure	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
E. Current transfers	7.9	8.4	8.4	8.0	8.0	9.0	10.2	10.4	10.4
To the private sector	2.0	2.3	2.2	2.2	2.8	3.0	2.8	2.8	3.2
To the public sector	5.9	6.2	6.2	5.8	5.2	6.0	7.4	7.6	7.1
a. Provinces and municipality of the City of Buenos Aires	5.3	5.5	5.6	5.2	4.7	5.5	6.8	7.1	6.5
b. Universities	0.6	0.6	0.6	0.6	0.5	0.5	0.5	0.5	0.6
(3) Economic result: Saving/Dissaving (1-2)	-0.3	-1.5	-1.5	-2.3	-0.8	1.3	3.9	3.6	4.1
(4) Capital resources	0.2	1.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0
(5) Capital expenditure	1.3	1.1	1.0	1.0	0.7	0.8	1.3	1.9	2.5
(6) Primary expenditure (2, excl. B+5)	18.0	19.0	18.6	18.2	16.9	18.2	19.6	20.1	20.4
(7) Total revenues including miscellaneous central government contributions	22.2	24.2	23.2	22.6	21.2	24.5	26.5	26.9	27.3
(8) Primary expenditure including miscellaneous central government expenditure	21.3	22.9	22.2	22.1	20.5	22.2	22.6	23.2	23.9
(9) Total primary surplus (7-8)	0.9	1.2	1.0	0.5	0.7	2.3	3.9	3.7	3.5
(10) Total expenditure	23.6	25.8	25.5	25.8	22.7	24.0	23.9	25.1	25.7
(11) Financial result (7-11)	-1.4	-1.7	-2.4	-3.2	-1.5	0.5	2.6	1.8	1.6
Total public debt (US\$ billion)	112.4	121.9	128.0	144.4	137.3	178.8	191.3	128.6	..
Total public debt (percentage of GDP)	38.0	43.0	45.0	57.0	127.7	139.6	125.7	70.6	..

.. Not available.

a Estimated for the first quarter.

Source: Ministry of the Economy and Production. Consulted at: <http://www.mecon.gov.ar>.

20. One of the main sources of pressure on the public finances has been the structural problem of transfers from the national government to the provinces. The revenue-sharing system makes the national government responsible for collecting most of the taxes but more than half of the expenditure takes place in the provinces. To remedy this situation, the Federal Government has been negotiating annually with the provinces. Moreover, the Law on the Federal Fiscal Responsibility Regime (*Ley de Régimen Federal de Responsabilidad Fiscal*) (Law No. 25.917, promulgated on 24 August 2004) has

¹¹ IMF (2005a).

been introduced. Among other things this Law stipulates that the rate of increase of primary public expenditure in the national and provincial budgets may not exceed the nominal rate of increase of GDP, sets limits on provincial debt and requires provincial and local governments to obtain authorization from the MEP before taking on further debt. The regime entered into force on 1 January 2005 and by May 2006 it had been adopted by 19 jurisdictions (including the national government).¹² The authorities have pointed out that even the provinces which have not adopted the regime are generating surpluses.

21. The public debt ratio increased considerably during the period under review (Table I.3), mainly as a result of the growing fiscal deficits (financial result) and the steep depreciation of the peso in 2002-2003. Argentina stopped repaying the principal and interest on its debt in December 2001; this suspension lasted for more than three years.

22. In January 2005, the Argentine authorities made a global offer to exchange a total of US\$82 billion in 152 different eligible claims for three new types of bonds at the rate of 32 centavos to the US dollar. The debt exchange closed in February 2005 with a participation rate of slightly over 76 per cent. Some US\$24 billion was refinanced internally, while about US\$38 billion was tendered from abroad, leaving principal in default totalling 20 billion still to be resolved. As a result of the conclusion of the agreements with its creditors, there was a substantial contraction in Argentina's public debt as a percentage of GDP. Moreover, the percentage of the Federal Government's debt stock denominated in pesos rose from 3 per cent to 37 per cent.¹³ At the beginning of 2006, the Government paid off all its US\$9.6 billion debt with the IMF. This reduced the debt/GDP ratio to under 65 per cent.

(iii) Monetary and exchange rate policy

23. Argentina's monetary and exchange rate policy is managed by the Central Bank of the Argentine Republic – BCRA (*Banco Central de la República Argentina*). Between 1991 and 2001, Argentine monetary policy was completely defined by the efforts to maintain a fixed exchange rate that linked the peso with the dollar at an exchange rate of one peso to the dollar, as established by the Law on Convertibility No. 23.928 of 27 March 1991.¹⁴

24. The fixed exchange rate regime led to a multilateral appreciation of the currency in real terms. At the same time, there was an increase in payments in the services balance, which contributed to a larger deficit on current account, and a rise in the level of external debt. This was accompanied by a heightened perception of country risk among depositors and investors, which in 2000-2001 led to severe capital flight.¹⁵ During the course of 2001, the Government adopted measures aimed at restoring some degree of exchange rate competitiveness.¹⁶ However, these were insufficient to prevent its continuing erosion and it was decided that more drastic measures were required.

25. Emergency Law No. 25.561 of 6 January 2002 amended various aspects of the Law on Convertibility and put an end to convertibility properly so-called. A flexible exchange rate system

¹² See <http://www2.mecon.gov.ar/cfrf/integrantes/integrantes.htm>.

¹³ IMF (2005a).

¹⁴ Under the Law on Convertibility, the Argentine monetary base could not exceed its international reserves, with a certain margin of flexibility. The BCRA controlled the money supply, by buying and selling US dollars at a fixed exchange rate. There were no restrictions on access to foreign currencies and no exchange controls were applied.

¹⁵ Bustelo, Pablo (2002), pp 9-14.

¹⁶ For example, Law No. 25.445 of 22 June 2001 provided for the exchange rate for foreign trade transactions to be fixed with respect to the dollar and the euro at a ratio of 50/50.

was introduced and that led to a sharp initial depreciation of the peso followed by a partial correction. Since 2002, monetary policy has been based on two main pillars: the setting of quantitative money aggregate targets, as an intermediate target for price stability; and the accumulation of reserves, as reinsurance against external shocks. The BCRA sets targets for the evolution of an objective monetary variable: between 2002 and the end of 2005, this variable was the monetary base, which remained within the established range for 10 consecutive quarters. Since 2006, the objective variable has been M2 (see below). The target setting must be consistent with an indicative range of inflation; for 2006, the BCRA agreed with the MEP a range of 8-11 per cent. The reserve accumulation policy has led to a considerable increase in reserves.

26. The exchange rate correction since the introduction of the floating regime at the beginning of 2002 has been greater than that in the neighbouring countries and has been accompanied by interventions by the BCRA in the foreign exchange market designed to reinforce a prudential policy of accumulation of international reserves. To prevent these interventions from affecting the achievement of the broad monetary base target, the BCRA has used various monetary regulation techniques which have made it possible to compensate for the monetary creation associated with the purchase of currencies.¹⁷

27. Starting with the 2006 Monetary Programme, and taking into account the resurgence in domestic credit which increased secondary money creation, the BCRA decided to use M2 as the objective monetary variable.¹⁸ The BCRA sets quarterly ranges for M2, which still leaves it sufficient flexibility in monetary policy to manage other variables in order to influence the liquidity of the economy ("fine tuning"), such as control of the short-term interest rate through daily intervention in the swap market, security trading operations, and intervention in the exchange market.¹⁹

28. The margin between lending and borrowing interest rates in national currency increased considerably during the financial crisis, with much of the increase reflecting the scarcity of domestic credit and the increased perception of risk. Since 2003 the gap has closed, but in 2005, coinciding with an acceleration in inflation, there was an increase in the margin between the rates on loans and deposits in the savings and loan associations, although the margin between the rates on loans and fixed-term deposits continued to narrow (Table I.4).

29. Between 1999 and 2001 Argentina experienced a period of deflation (Table I.4) induced by recession and the fixing of the exchange rate. Later, inflation increased considerably. As a result of the skewed monetary policy and severe recession, prices rose more slowly in 2003-2004. Since 2005 there has been a rebound in inflation due to strong domestic demand and high international raw material prices. The BCRA considers that the rebound in inflation is linked with a restructuring of relative prices between tradeables and non-tradeables.²⁰

¹⁷ The early cancellation of rediscounts (through the "matching" programme and advance payments), swap operations, and the placement of Central Bank bills and notes, with a maturity of from one month to two years, have been factors in the absorption of the monetary base.

¹⁸ Sum of the currency in circulation, private and public sector current account deposits in pesos and private and public sector savings deposits in pesos.

¹⁹ In the swap market (short-term bank transactions), the BCRA establishes a short-term reference interest rate "corridor", which in 2005 was 5-6 per cent.

²⁰ Redrado, Martín (2005).

Table I.4
Main monetary indicators, 1998-2006
 (Percentage)

	1998	1999	2000	2001	2002	2003	2004	2005	2006 ^a
Money and credit supply (rate of variation over 12 months)									
Broad monetary base	11.0	6.5	-7.3	-16.8	80.4	26.3	12.4	4.3	26.9
M1	2.6	-2.7	-4.2	-2.9	76.5	27.2	29.7	27.8	5.9
M2	5.0	-2.4	-3.3	13.7	17.6	35.8	39.7	22.4	7.3
M3	11.2	2.4	2.9	-18.9	18.2	31.5	26.1	20.3	15.4
As a percentage of GDP									
Broad monetary base/GDP	8.6	9.2	8.6	8.1	10.6	11.4	11.0	9.5	10.5
M1/GDP (percentage of GDP)	8.5	8.3	8.1	9.0	11.5	12.4	13.7	14.3	13.3
M2/GDP (percentage of GDP)	13.2	13.1	12.8	16.7	14.3	16.4	19.5	19.4	18.3
M3/GDP (percentage of GDP)	30.4	31.5	32.8	30.5	26.2	29.1	31.3	30.7	31.1
Deposits (percentage of GDP)	25.7	26.4	27.9	25.3	19.4	22.1	23.8	23.2	23.9
in pesos	11.9	11.2	11.1	7.3	18.6	20.6	21.4	21.0	21.4
in foreign currencies	13.8	15.2	16.8	18.0	0.8	1.4	2.5	2.1	2.5
Total private sector loans (percentage of GDP)	23.1	22.5	21.5	19.8	10.0	7.5	8.1	9.2	10.5
Interest rates (end of period)									
Lending rate call (up to 15 days)	7.5	8.2	12.1	..	6.6	1.7	4.5	8.4	8.4
Lending rate pesos (Prime)	10.7	13.8	14.8	..	33.1	10.1	5.6	7.1	9.1
Deposits in pesos (savings banks)	2.9	3.1	2.5	1.8	2.1	0.8	0.7	0.9	0.8
Deposits in pesos (fixed term 30-59 days)	8.4	10.2	11.1	6.6	23.0	3.9	2.5	4.3	7.0
Deposits in dollars (savings banks)	2.4	3.0	3.2	1.9	1.8	0.2	0.1	0.1	0.1
Interest margin (lending-savings banks)	7.8	10.7	12.3	..	31.0	9.3	4.9	6.2	8.4
Interest margin (lending-fixed term)	2.3	3.6	3.7	..	10.1	6.2	3.1	2.8	2.2
Inflation (percentage variation at end of period)									
Consumer price index (retail prices)	0.7	-1.8	-0.7	-1.5	41.0	3.7	6.1	12.3	11.0 ^c
Wholesale price index	-6.3	1.2	2.4	-5.3	118.0	2.0	7.9	10.7	12.0 ^c
Exchange rate									
Exchange rate (average for period Arg\$/US\$)	1.0	1.0	1.0	1.0	3.1	2.9	2.9	3.0	3.1 ^c
Multilateral real exchange rate variation ^b (Dec.-Dec.)	1.9	-10.8	0.4	-5.7	135.0	-10.9	5.2	1.0	..
Real effective exchange rate to the US\$ ^b (Dec.-Dec.)	0.6	3.4	4.3	4.0	147.8	-14.9	-0.9	-6.2	-0.8 ^c
Real effective exchange rate to the UR\$ (Dec.-Dec.)	-2.3	-31.9	6.8	-15.7	115.4	-10.5	8.0	16.7	7.1 ^c

.. Not available.

a As at 30 September 2006.

b A minus sign indicates appreciation, a plus sign depreciation.

c 12 months to June.

Note: The data on deposits, loans and interest rates correspond to the information in the Statistical Bulletin, which is available on the BCRA website. The broad monetary base corresponds to the item "Monetary liabilities" up to the end of 2001, and includes quasi-monies up to March 2004, the redemption date. The money aggregates include pesos plus US dollars from the private and public sectors. M1 includes money in circulation and public- and private-sector current account deposits. M2 includes M1 plus private and public sector savings bank deposits. M3 includes M2 and private- and public-sector time and other deposits. Only the end-of-period balances are considered.

Source: BCRA and MEP.

(iv) Balance of payments

30. The current account of Argentina's balance of payments was heavily in deficit between 1998 and 2000. Because of the dramatic decline in imports resulting from the crisis of 2001 this account returned to surplus in 2002, although as economic growth has picked up again the surplus has been eroding (Table I.5). The passage from deficit to surplus on current account corresponded with the suspension of external debt payments in 2001, and the subsequent external debt reduction through renegotiation. This also helped domestic savings to increase and exceed investment as a percentage

of GDP. Economic recovery was accompanied by a contraction of the surplus on current account from 8.1 per cent of GDP in 2002 to 2.8 per cent in 2005.

31. Since 2002, the goods and services trade balance has been in surplus, although in 2003 the surplus began to shrink (Table I.5). The merchandise balance has been in surplus since 2001, reaching a record level in 2002, mainly as a result of increased exports. Initially, there was a fall in imports, but since 2003 they have picked up as domestic demand has recovered, although they have not yet returned to their 1998 levels. Argentina's services balance is still in deficit. Between 1999 and 2001, Argentine exports of goods and services were affected by a loss of competitiveness, but following the exchange rate correction they resumed the path of more dynamic growth. Their share of GDP rose to 27.7 per cent in 2002, but then fell back to 24.6 per cent in 2005

Table I.5
Balance of payments, 1998-2006
(US\$ million)

	1998	1999	2000	2001	2002	2003	2004	2005	2006 ^a
I. Current account	-14,482	-11,944	-8,981	-3,291	8,668	7,982	3,278	5,407	1,179
A. Trade account	-7,541	-4,906	-1,832	3,522	15,589	15,410	11,595	11,048	2,338
Exports	31,288	28,028	31,277	31,170	28,946	34,163	39,404	46,356	11,560
Goods (f.o.b.)	26,434	23,309	26,341	26,543	25,651	29,939	34,550	40,013	9,755
Services	4,854	4,719	4,936	4,627	3,295	4,224	4,854	6,343	1,805
Imports	38,829	32,933	33,108	27,648	13,357	18,753	28,177	35,308	9,223
Goods (f.o.b.)	29,531	24,103	23,889	19,158	8,473	13,134	21,311	27,300	7,042
Services	9,298	8,830	9,219	8,490	4,884	5,619	6,866	8,008	2,181
Goods balance	-3,097	-795	2,452	7,385	17,178	16,805	13,239	12,714	2,714
Services balance	-4,444	-4,111	-4,284	-3,863	-1,589	-1,395	-1,644	-1,666	-376
B. Income	-7,405	-7,491	-7,548	-7,237	-7,484	-7,970	-8,922	-4,986	-1,321
Investment income	-7,400	-7,502	-7,556	-7,241	-7,466	-7,952	-8,896	-4,961	-1,314
Loans	6,109	6,040	7,383	5,816	3,003	3,064	3,445	4,003	1,164
Interest	5,240	5,442	6,405	5,179	2,653	2,613	2,818	3,168	878
Profits/Dividends	869	598	978	635	350	451	627	835	286
Liabilities	13,509	13,542	14,940	13,055	10,469	10,016	12,341	10,283	2,477
Interest	10,347	11,329	12,352	12,162	10,349	9,932	9,774	6,637	1,257
Profits	3,162	2,213	2,588	893	120	1,084	2,567	3,646	1,220
Other income	-5	11	8	4	-18	-18	-27	-32	-7
C. Current transfers	464	453	399	424	564	545	627	671	163
II. Capital and financial account	18,354	13,772	8,737	-5,439	-11,404	-3,176	1,782	2,765	-8,134
A. Capital account	73	149	106	157	406	70	43	90	11
B. Financial account	18,281	13,623	8,631	-5,595	-11,810	-3,246	1,739	2,674	-8,145
Banking sector	3,505	1,330	67	11,588	-2,573	-3,001	-3,097	-4,332	-9,704
Non-financial public sector	9,361	10,886	8,258	-3,385	3,618	4,637	4,952	3,509	949
Non-financial private sector	5,414	1,407	305	-13,798	-12,856	-4,882	-116	3,498	610
III. Errors and omissions	-434	-628	-196	-3,354	-1,780	-1,225	259	686	321
IV. Variation in int. reserves	3,438	1,201	-439	-12,083	-4,516	3,581	5,319	8,857	-6,633
Memorandum items:									
Gross official reserves	26,524	27,831	26,491	19,425	10,476	14,119	19,646	28,077	25,530
Gross external debt	147,634	152,563	155,015	166,722	156,748	164,918	171,115	124,230	..
Current account/GDP (%)	-4.9	-4.2	-3.2	-1.2	8.1	6.0	2.2	2.8	..
Total external debt/GDP (%)	49.4	53.8	54.5	62.1	145.7	128.6	112.5	64.3	..

.. Not available.

a First quarter.

Source: MEP.

32. The financial account, which showed a surplus between 1998 and 2000, went sharply into deficit in 2001-2002, mainly on account of the massive outflow of private capital during those years. However, starting in 2003, a net inflow of short-term capital was again observed. Gross international reserves, which fell dramatically during the financial crisis, began recovering in 2003 and in 2005 stood just above 1999 levels. Argentina's total external debt continued increasing up to 2004, a situation aggravated by the accumulation of unpaid balances. When the debt was renegotiated in January 2005, the balance was reduced, falling from 112.5 per cent of GDP in 2004 to 64.3 per cent in 2005.

(3) TRADE AND INVESTMENT FLOWS

(i) Evolution of merchandise trade

33. After contracting in 2002, exports began to recover in 2003 and this trend continued in 2004-2005. Between 1998 and 2005, exports expanded at an average annual rate of 6.1 per cent, reaching a record level of US\$40.106 billion in 2005 (Tables AI.1 and AI.3). Imports contracted, but then began to recover in 2003 (Tables AI.2 and AI.4). The initial contraction was attributable in part to the recession that gripped the Argentine economy during the period 1999-2002, and subsequently to an import substitution process partly induced by exchange rate policy but also encouraged by certain trade policies. Total Argentine trade (exports plus imports) increased its share of GDP from 23.3 per cent in 1998 to 42.9 per cent in 2005.

34. One of the factors responsible for the recovery in exports was an improvement in Argentina's terms of trade, with increases in the prices of some of its main export products, together with the restoration of exchange rate competitiveness following the introduction of the floating regime early in 2002. Exports responded positively to the change in relative prices, despite a sustained increase in domestic demand, supply problems, difficulties in obtaining credit, and the use of export taxes (Chapter III(3)).

(a) Composition of merchandise trade

35. Argentina is a major exporter of agricultural products and manufactures of agricultural origin, which continue to be the main export item with 47.8 per cent of the total in 2005. Soya bean, grain oils, wheat, maize (corn) and bovine meat are the chief export products (Table AI.1). Exports of soya bean and oils have grown rapidly, as have exports of mineral products, particularly petroleum.

36. On the other hand, the share of manufactured goods in total exports, those of agricultural origin excluded, fell from 34.9 per cent in 1998 to 30.6 per cent in 2005 (Table AI.1), partly owing to an increase in domestic demand.²¹ It should be noted that the share of manufactures in total exports increased between 2003 and 2005. The authorities have observed that, although they did not benefit from the high prices enjoyed by agricultural products, exports of industrial products performed well following the implementation of the competitive exchange rate policy. During the period 1998-2005, the trend in exports of chemical, plastic, aluminium, and iron and steel industry products was positive, whereas exports of automotive products declined.

37. As a major exporter of agricultural products and increasingly of manufactured products, Argentina would benefit considerably from the success of the Doha Round. Estimates based on a

²¹ The result is different if the ISIC classification is used. In this case, exports of manufactured goods increased, from 71.8 per cent of the total in 2002 to 73.7 per cent in 2005, while primary products declined slightly.

World Bank study indicate that total liberalization of the agricultural sector at global level would increase the rate of growth of Argentina's GDP by two percentage points a year.²²

38. The composition of Argentina's imports remained relatively stable between 1998 and 2005 (Table AI.2). In the latter year, 86.3 per cent of imports were manufactured products. The share of fuel (mainly coal) and electrical energy imports increased to 5 per cent in 2005, reflecting the stronger demand following from the resumption of economic growth, together with higher international market prices.

(b) Trends in merchandise trade

39. Despite a loss of share during the period under review, the countries of the American continent continue to be the main destination for Argentine exports, accounting for 52.5 per cent of the total exported in 2005 (Table AI.3). The reduced share of the American continent is primarily attributable to the decline in the value of Argentine exports to other MERCOSUR countries (especially Brazil), which in 2005 was lower than the confirmed figure for 1998. After the European Union, treated as a group, and Brazil, the main destinations for Argentine exports were Chile and the United States. Asia's share of exports rose, largely as a result of increased exports to China, which has become the largest market for Argentine exports to the Asian continent.

40. Imports from the American continent increased from 52 per cent in 1998 to 63.4 per cent of the total in 2005 (Table AI.4). Imports from other MERCOSUR countries (especially Brazil) increased their share to 40.5 per cent in 2005. This reflects their preferential access to the Argentine market, which partly offset the effect of the depreciation of the Argentine peso on exports from the other MERCOSUR countries to Argentina. The shares of the United States and the European Union declined, while that of China increased substantially.

(ii) Trade in services

41. Traditionally, Argentina runs a deficit in services trade, although in recent years that deficit has been receding from the levels reached in 1998-2001 (Table I.6). Argentina shows a deficit in all branches of its services trade, with the exception of construction and computer and information services.

42. The most important items on both sides of the balance sheet are travel and transport, which represent about 75 per cent of services exports and more than two thirds of imports. Both exports and imports of services were considerably affected by the financial crisis of 2001-2002 but have since recovered, especially exports. Imports in 2004 and 2005 were still somewhat below 2001 levels.

Table I.6
Trade in services, 1998-2005
(US\$ million)

	1998	1999	2000	2001	2002	2003	2004	2005
Balance	-4,444	-4,111	-4,283	-3,863	-1,590	-1,397	-1,666	-1,666
Inflows	4,854	4,719	4,936	4,627	3,295	4,224	5,214	6,343
Transport	1,155	1,092	1,145	893	760	939	1,152	1,306
Travel	3,025	2,898	2,904	2,642	1,535	2,006	2,563	3,336
Communication services	193	169	175	187	151	149	185	212
Construction services	22	28	7	0	16	41	61	46
Insurance services	0	0	12	0	0	0	0	0

Table I.6 (cont'd)

²² Guadagni, Gustavo (2005).

	1998	1999	2000	2001	2002	2003	2004	2005
Financial services	6	5	6	4	1	1	2	3
Computer and information services	83	93	147	189	115	153	178	200
Royalties	26	25	37	47	30	49	59	52
Business, professional and technical services	180	229	324	471	537	695	802	922
Personal, cultural and recreational services	11	16	18	38	83	111	126	154
Government services	153	161	160	158	67	81	86	112
Outflows	9,298	8,830	9,219	8,490	4,885	5,622	6,880	8,008
Transport	2,784	2,419	2,413	2,104	949	1,146	1,622	1,958
Travel	4,230	4,195	4,425	3,893	2,328	2,511	2,964	3,341
Communication services	173	140	205	239	223	231	234	268
Construction services	4	6	0	0	8	37	31	2
Insurance services	296	271	200	219	52	149	158	218
Financial services	203	189	170	185	49	112	102	198
Computer and information services	90	99	149	191	115	122	143	168
Royalties	590	582	580	564	330	374	492	586
Business, professional and technical services	553	584	648	639	561	603	757	852
Personal, cultural and recreational services	155	114	171	228	91	106	131	155
Government services	220	231	260	228	180	231	246	262

Source: MEP and National Directorate of International Accounts – DNCI (*Dirección Nacional de Cuentas Internacionales*).

(iii) Foreign investment

43. Argentina is a net recipient of foreign direct investment (FDI) flows. The main investors in Argentina are (in order of importance): Spain, United States, Netherlands, France, Chile, Germany, United Kingdom, and Italy (Table I.7). By activity, the sectors that have received most foreign investment are oil, the manufacturing industry (especially the chemical, food and beverages, and automotive industries), electricity, telecommunications, trade and banking.

Table I.7
Foreign investment position, by investor and by activity, 1998-2004
(US\$ million)

	1998	1999	2000	2001	2002	2003	2004
1. By investor							
Europe	20,056	31,263	36,873	44,029	23,714	26,234	27,482
Germany	1,773	1,897	2,090	1,876	1,166	1,472	1,619
Spain	3,602	12,308	16,612	18,413	10,063	11,786	11,210
France	3,288	4,441	4,971	6,734	2,685	2,888	3,213
Italy	1,614	2,513	2,729	3,107	1,215	1,248	1,313
Netherlands	4,819	5,090	5,470	6,426	3,151	3,230	4,386
United Kingdom	2,877	2,630	2,359	2,239	1,543	1,619	1,346
Other	2,084	2,385	2,642	5,234	3,891	3,991	4,395
North America	16,206	17,402	17,641	21,777	12,321	12,232	12,491
United States	14,720	15,418	15,864	19,392	10,888	10,858	10,986
Other	1,485	1,983	1,777	2,385	1,433	1,374	1,505
Central America and Caribbean	5,043	7,170	6,388	5,014	1,267	3,607	3,324
South America	5,629	5,056	5,113	6,638	4,899	5,391	6,141
Chile	3,128	2,992	3,445	3,616	2,090	2,118	2,236
Other	2,501	2,064	1,667	3,022	2,809	3,273	3,905
Other regions	864	1,036	586	2,046	945	833	1,146
Total	47,797	61,926	67,601	79,504	43,146	48,298	50,583
2. By activity							
Oil	6,294	14,813	16,888	18,104	11,749	12,951	13,976
Mining	1,091	1,083	769	938	356	421	743

Table I.7 (cont'd)

	1998	1999	2000	2001	2002	2003	2004
Manufacturing industry	17,345	18,610	19,919	22,562	13,721	14,818	16,497
Food, beverages, and tobacco	4,574	5,277	5,805	6,751	3,958	3,904	4,453
Textiles and tanned leather	256	226	262	305	175	168	135
Paper	1,358	1,271	1,517	1,460	832	913	1,059
Chemicals, rubber and plastics	4,642	5,302	5,740	7,340	4,230	4,638	4,922
Cement and ceramics	837	774	750	839	524	618	616
Metals and metal articles	1,404	1,336	1,402	1,392	1,115	1,785	1,900
Machinery and equipment	1,016	1,415	1,280	1,329	845	585	615
Automotive industry	3,259	3,010	3,162	3,146	2,042	2,207	2,798
Electricity, gas and water	7,346	8,306	7,951	9,043	3,969	4,876	5,053
Commerce	1,970	3,002	2,938	5,253	3,086	2,958	2,645
Transport and communications	4,062	5,196	6,997	9,473	4,785	4,349	3,992
Banking	5,671	6,403	7,206	7,012	2,610	2,934	2,436
Other	4,019	4,513	4,933	7,119	2,870	4,991	5,241
Total	47,797	61,926	67,601	79,504	43,146	48,298	50,583
Financial sector	5,671	6,403	7,205	7,012	2,610	2,934	2,436
Non-financial sector	42,126	55,523	60,396	72,491	40,536	45,364	48,147
Debt between affiliated enterprises	5,705	7,274	8,354	19,938	24,490	30,558	32,627
Capital	36,421	48,249	52,041	52,553	16,046	14,806	15,520
Foreign investment flows (net)	7,291	23,988	10,418	2,166	2,149	1,652	4,274

Note: As from 2001 there is a change of series. As the investment position is estimated at book value, it differs from an estimate based on adding up the flows.

Source: National Statistics and Census Institute of the Argentine Republic, DNCI.

44. The years 1999 and 2000 were marked by considerable foreign investment inflows connected with privatizations. The flows into the oil sector and some services areas, such as financial services and telecommunications, were particularly significant. The flow of FDI into Argentina fell substantially between 2001 and 2003, but subsequently strengthened. In 2004, the stock of foreign investment in Argentina totalled US\$50.583 billion. There has been a change in the main component of investment, namely debt between affiliated enterprises in place of new capital injections.

(4) OUTLOOK

45. At the beginning of the year, the Argentine authorities were forecasting that GDP would grow at a rate of 4 per cent in 2006, and between 3 and 4 per cent during the period 2007-2010.²³ According to the survey of expectations carried out by the BCRA, the market is expecting output to increase by somewhat less than 8 percentage points in 2006 and by almost 6 per cent in 2007. This growth would be accompanied by a gradual appreciation of the real exchange rate, and a slow decline in the trade surplus. The authorities consider that inflation will oscillate around 12 per cent in 2006 and 2007²⁴ and estimate the potential economic growth rate at about 4 per cent. For its part, the IMF was forecasting that GDP would grow by 7.6 per cent in 2006 and by 4 per cent in 2007, while consumer prices would increase by 12.9 and 15 per cent, respectively.²⁵

46. Although the international context looks favourable for Argentina, the outlook for the economy is not entirely free of risk, especially the risk of inflation. A substantial increase in international interest rates could put pressure on economic growth and government finance. The authorities consider that the exposure risk has declined with progress in the economic situation, which is characterized by a primary and financial surplus in the public accounts, a surplus in the current

²³ See MEP (2006c) and BCRA, *Relevamiento de Expectativas de Mercado (REM)*.

²⁴ BCRA, *Relevamiento de Expectativas de Mercado (REM)*.

²⁵ See <http://www.imf.org/external/country/ARG/index.htm>.

account of the balance of payments, and a high rate of economic growth. This improvement in the economic situation has translated into a substantial reduction in country risk. However, many of the policies applied are of an emergency or short-term nature: the challenge will be to find sustainable ways of overcoming the market deficiencies and price and supply distortions that still persist.