ARGENTINA

1. General trends

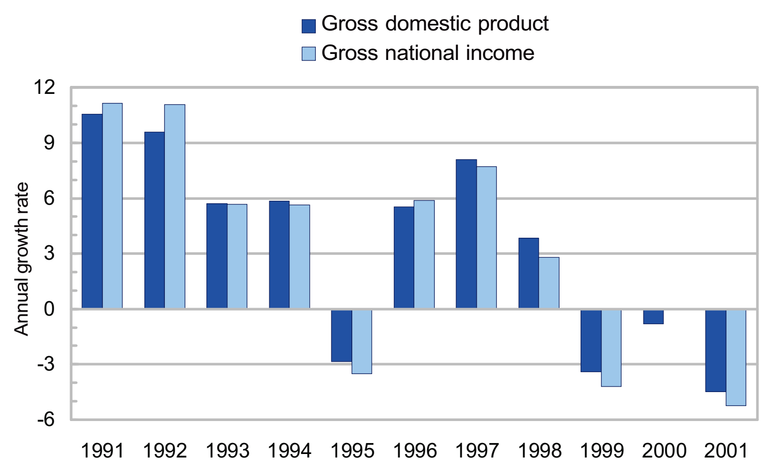
The drawn-out economic crisis in Argentina reached unprecedented proportions in 2001. GDP contracted more sharply, shrinking by almost 11% in the fourth quarter and receding by 4.5% over the year as a whole. In 2002 the recession deepened, prompting forecasts that the level of activity would fall off by more than 10%. At the end of 2001, prices suddenly swung upward; the CPI had exhibited deflation that year (-1.5%), but after the currency devaluation there was a palpable increase in prices, which followed a decade of stability. Meanwhile, unemployment continued to rise, reaching extremely high levels, while merchandise trade accumulated a large surplus owing to the slump in imports.

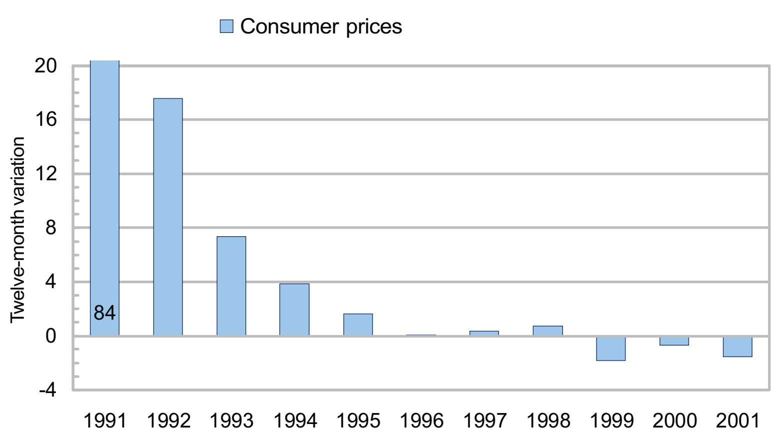
IN ADDITION to the above factors, private capital flows suddenly changed course, resulting in a net outflow of more than US$ 4 billion despite the substantial increase in credit from international institutions. This considerably reduced the level of international reserves, despite the narrowing of the current-account deficit. The substantial drop in tax receipts had a strong impact on public finances, widening the national public-sector deficit to over 3% of GDP, while the government's sources of credit were cut off. Liquid asset holdings (including foreign-currency deposits) shrank by nearly 20%, reflecting a lack of confidence in the economy's future direction.

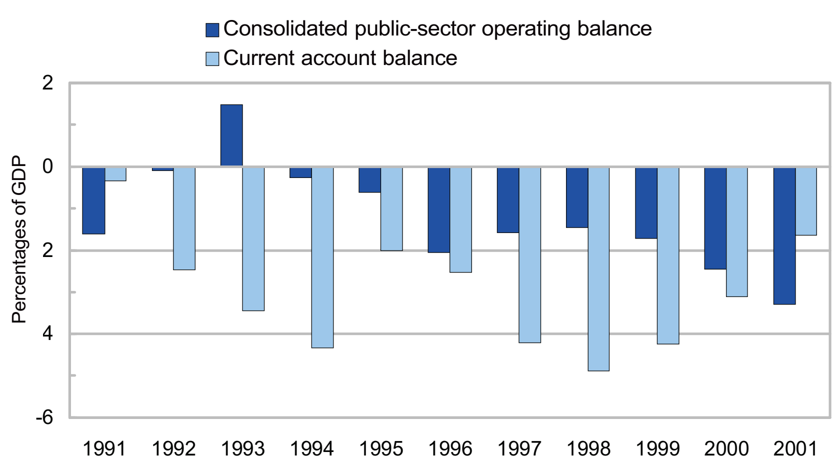
As a result of the poor performance in real, financial and fiscal terms, the monetary convertibility system broke down and the government defaulted on its debt servicing payments. The collapse of the convertibility regime, after a run on deposits and reserves that prompted the authorities to impose controls on foreign-exchange movements and cash withdrawals from banks, generated large-scale economic disruption. For a decade, the fixed parity with the dollar had been a key reference point for economic decision-making, especially with regard to credit-related transactions, many of which were denominated in foreign currency. In early 2002, the sudden alteration of the exchange rate in a climate of extreme economic and political uncertainty threatened the ability to pay of debtors whose incomes were determined on the basis of domestic prices and activity. This ran counter to the contractual rights of creditors and undermined the asset position of many families and firms.

The conversion of dollar contracts to pesos (at a different rate for bank loans and deposits) gave rise to heated debate, as did the rescheduling of fixed-term deposits and the imposition of ceilings on bank withdrawals. Owing to the steep slide in demand for domestic assets and severe difficulties in managing the

Figure 1
ARGENTINA: MAIN ECONOMIC INDICATORS







Source: ECLAC, on the basis of official figures.

money supply, the price of the dollar shot up by about 250% between the end of 2001 and June 2002. The rise in prices was significant, but much smaller than the exchange-rate depreciation, resulting in a substantial increase in the real exchange rate. At the same time, domestic demand contracted even further, helping to generate a huge trade surplus. Economic upheaval was manifested in various ways: the choking-off of credit flows, a severe liquidity squeeze coupled with strong demand for foreign exchange, the public sector's difficulty in financing basic expenditure even without making interest and principal payments on its debt, the deadlock in the dialogue on the restructuring of public and private debt and public utility rates and the delay in opening talks with the International Monetary Fund (IMF).

2. Macroeconomic policy

The authorities tried, without success, to contain this highly turbulent situation. At the end of 2000, the government and IMF had come to an agreement under which large-scale financing would be provided, subject to compliance with specified goals. The sense of relief that this produced in the credit markets was short-lived. In March 2001, in view of signs that Argentina's fiscal results were not according to plan, its country-risk rating was ratcheted up substantially. The Minister of the Economy resigned from his post and the new economic authorities announced a programme of drastic cuts in government spending, which roused opposition and could not be implemented, leading to another change of authority a few days later. The new economic team announced that it would address fiscal and external competitiveness problems by reviving activity, while the Congress delegated a wide range of economic powers to the executive branch and imposed a tax on bank transactions. In mid-year the government conducted a debt swap (mainly with local creditors) for a total of US$ 30 billion; the operation extended the debt's maturity, but at a very high rate of interest, heightening doubts about fiscal and external solvency. At the same time, a change in the exchange-rate regime was announced: for commercial operations, the peso's value would be based on a currency basket consisting of the dollar and the euro. This measure, which was intended to increase the commercial exchange rate (by about 7% at the initial euro-dollar value) without altering the core features of the convertibility system, sparked even greater uncertainty as to the future of the monetary regime.

In view of the flare-up of tension in financial markets and indications that the government had lost all access to credit, the authorities adopted a rule on primary cash expenditure, under which outlays would be adjusted according to income on a monthly basis; in addition, government wages and pensions were cut by 13%. In any case, the deepening recession continued to erode the tax receipts of both the federal government and provincial governments, a number of which began to issue bearer papers that circulated as "emergency money". Meanwhile, bond prices showed that operators considered default a likely possibility. The growing doubts about the solidity of the financial system triggered a rapid outflow of deposits, and the Central Bank's international reserves fell substantially. The government turned to IMF, which advanced part of the assigned funds, although that entity and the United States Treasury publicly expressed scepticism about the policies' sustainability, and the possibility of restructuring the public debt was explicitly raised. The parliamentary elections in October indicated widespread dissatisfaction with the economic situation and the actions of political authorities.

As a result of another run on the banks and on foreign exchange in November, in early December the authorities restricted foreign-exchange purchases and transfers abroad. They also imposed a ceiling on cash withdrawals from banks, which had a serious impact on economic activity. In mid-December, popular uprisings led to the resignation of the President. The National Congress elected an interim official, who suspended payments on the public debt and announced that a new non-convertible currency would be issued, while the peso would retain its parity with the dollar. This monetary regime was never implemented, as the new President resigned a few days after taking office. The Congress then appointed a new head of the executive branch, whose mandate runs up to the end of 2003.

The new government established a dual foreign exchange market, fixed the price of the dollar at 1.40 pesos for commercial operations, adopted a floating rate for other authorized transactions and announced that the money supply would be regulated on the basis of a tight fiscal policy. The devaluation raised questions about the

Table 1
ARGENTINA: MAIN ECONOMIC INDICATORS

	1993	1994	1995	1996	1997	1998	1999	2000	2001[a]
	Annual growth rates [b]								
Growth and investment									
Gross domestic product	5.7	5.8	-2.8	5.5	8.1	3.9	-3.4	-0.8	-4.5
Per capita gross domestic product	4.3	4.5	-4.1	4.2	6.7	2.5	-4.6	-2.0	-5.6
Gross domestic product, by sector									
Goods	5.4	5.7	-4.7	5.2	8.4	3.9	-5.9	-3.9	-5.9
Agriculture	2.4	7.5	5.6	-1.2	0.5	8.7	2.5	-1.7	1.0
Mining	9.9	13.8	16.4	4.5	0.7	-3.8	-3.3	6.7	4.4
Manufacturing	4.6	4.5	-7.2	6.5	9.2	1.8	-7.9	-3.8	-7.5
Construction	10.9	5.8	-12.2	8.4	16.6	8.7	-7.9	-9.3	-12.1
Basic services	6.9	10.4	3.0	6.3	10.5	8.6	-0.2	2.8	-3.2
Electricity, gas and water	11.1	10.8	7.4	4.1	8.2	7.6	3.6	6.6	1.1
Transport, storage and communications	5.3	10.3	1.7	6.9	11.2	8.9	-1.3	1.7	-4.6
Other services	5.6	5.9	-2.4	5.3	7.3	4.1	-1.7	0.3	-4.0
Commerce, restaurants and hotels	3.4	6.7	-7.5	7.9	10.9	3.4	-6.9	-2.4	-7.8
Financial establishments, insurance, real estate and business services	9.9	9.5	-0.9	6.1	7.3	7.0	-0.5	1.3	-4.5
Total consumption [c]	5.3	5.0	-3.6	5.9	7.9	2.1	-1.3	-0.5	-5.2
General government	5.3	0.4	0.8	2.2	3.2	3.4	2.6	0.6	-2.1
Private	...	5.9	-4.4	6.7	8.8	1.8	-2.0	-0.7	-5.8
Gross domestic investment	15.3	13.7	-13.1	8.9	17.7	6.5	-12.6	-6.8	-15.9
Exports of goods and services	4.7	15.1	22.6	7.8	11.4	10.6	-1.3	2.7	2.9
Imports of goods and services	14.9	21.1	-10.0	17.4	27.2	8.4	-11.3	-0.2	-14.0
	Percentages of GDP [d]								
Gross national income	99.0	98.9	98.3	98.7	98.4	97.4	96.6	97.4	96.7
Gross domestic investment	18.6	20.0	17.9	18.5	20.1	20.7	18.7	17.6	15.5
National saving	14.6	15.1	15.7	15.7	15.3	15.0	13.7	14.0	13.6
External saving	4.0	4.9	2.2	2.8	4.8	5.7	5.0	3.6	1.9
	Percentages								
Employment and wages									
Labour force participation rate [e]	41.3	41.0	42.0	41.5	42.2	42.2	42.6	42.6	42.5
Open unemployment rate [f]	9.6	11.5	17.5	17.2	14.9	12.9	14.3	15.1	17.4
Real average wage (index: 1995=100) [g]	100.4	101.1	100.0	99.9	99.3	99.0	100.1	101.6	100.2
	Growth rates								
Prices (December-December)									
Consumer prices	7.4	3.9	1.6	0.1	0.3	0.7	-1.8	-0.7	-1.5
Wholesale prices	0.1	5.8	6.0	2.1	-0.9	-6.3	1.2	2.4	-5.3
External sector									
Terms of trade (index: 1995=100) [d]	104.8	105.6	100.0	108.5	108.9	103.9	98.5	108.8	108.2
Nominal exchange rate (pesos per dollar)	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Real effective exchange rate for imports (index: 1995=100)	95.4	94.6	100.0	101.9	99.0	96.7	90.0	90.6	88.3
	Millions of dollars								
Balance of payments									
Current account	-8,162	-11,157	-5,211	-6,879	-12,342	-14,632	-12,001	-8,864	-4,429
Trade balance (goods and services)	-5,687	-7,925	-1,101	-1,822	-6,572	-7,613	-4,951	-1,730	3,486
Exports	13,269	16,023	21,162	24,043	26,431	26,434	23,309	26,410	26,655
Imports	-15,633	-20,162	-18,804	-22,283	-28,554	-29,531	-24,103	-23,852	-19,148
Capital and financial accounts [h]	20,405	11,371	4,928	11,846	16,639	19,047	14,834	8,871	-13,503
Overall balance	11,090	- 682	-2,323	3,266	3,306	4,092	2,026	-1,218	-21,459
Variation in reserve assets (- indicates an increase)	-4,250	- 682	102	-3,882	-3,273	-3,438	-1,200	439	12,083

Table 1 (concluded)

	1993	1994	1995	1996	1997	1998	1999	2000	2001[a]
	Percentages								
External debt	30.5	33.2	38.2	40.6	42.7	47.5	51.3	51.3	52.0
Gross debt (as a percentage of GDP)									
Net interest	10.4	11.1	12.3	13.7	14.1	17.8	21.1	18.9	23.5
(as a percentage of exports) [i]									
	Percentages of GDP								
Central government	15.1	14.9	14.0	13.0	13.7	13.7	14.2	15.3	14.5
Current income	14.4	14.7	15.2	14.6	14.1	14.2	15.9	16.5	17.6
Current expenditure	0.7	0.1	-1.2	-1.6	-0.4	-0.5	-1.7	-1.2	-3.0
Saving	0.3	1.0	0.7	1.3	1.1	1.2	1.3	0.9	0.9
Capital expenditure (net)	0.4	-0.9	-1.9	-2.8	-1.4	-1.8	-3.0	-2.2	-3.9
Financial balance	1.5	-0.3	-0.6	-2.1	-1.6	-1.5	-1.7	-2.5	-3.3
Non-financial public sector balance									
	Growth rates								
Money and credit									
Monetary balance of banking system	33.8	27.6	5.6	12.1	22.3	13.8	6.7	3.2	-2.7
Net domestic credit	-61.2	-9.6	112.8	14.0	-3.5	29.1	33.1	4.2	19.8
To public sector	23.7	8.8	-0.6	9.5	17.0	11.9	-2.8	-4.8	-19.2
To private sector	-38.8	-46.0	33.8	1.5	-34.1	21.6	-26.0	-80.7	…
Money (M1)									
Local currency savings	48.8	17.1	-2.4	18.1	24.3	13.0	3.3	3.2	-19.4
and time deposits	34.0	13.4	1.7	10.8	14.7	0.8	-2.0	-6.2	-19.2
M2	29.9	12.0	0.0	4.7	13.6	1.3	1.5	-8.0	-28.6
Dollar deposits									
	Annual rates								
Real interest rate (annualized, %)	0.5	3.8	8.2	7.1	6.4	6.6	9.4	9.4	15.8
Deposit rate	3.1	5.7	14.0	10.3	8.7	9.6	12.4	12.2	24.2
Lending rate									
Equivalent interest rate in	11.3	8.1	11.9	7.4	8.0	7.6	8.0	8.3	14.8
foreign currency [j]									

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1993 pesos. [c] Includes changes in stocks. [d] Based on constant 1995 dollars. [e] Percentages of the total population in urban areas. [f] Percentages of the economically active population in urban areas. [g] Refers to manufacturing industry. [h] Capital pending classification according to the methodology used in the fifth edition of the *Balance of Payments Manual*. Includes the banking sector and the non-financial public and private sectors. Includes errors and omissions. [i] Refers to net interest as shown in the balance of payments, divided by exports of goods and services. [j] Interest rate on deposits, deflated by the variation in the exchange rate.

rules to be applied to financial contracts, especially those denominated in dollars. After intense debate and amid widespread protest, the government decided that all debts between private agents, with the exception of bank deposits, would be converted to pesos at one-to-one parity with the dollar and would then be adjusted according to an index based on CPI variations. Dollar deposits were converted at a rate of 1.40 pesos, while the question of how to deal with the exchange-rate differences arising from the different conversion rates for bank assets and liabilities was left pending. At the same time, customers continued to demand the return of deposits in the original currency.

Faced with the prospect of mass fund withdrawals that could force the sudden closure of several banks, the government provided for the rescheduling of fixed-term deposits. The restrictions on cash withdrawals from current and savings accounts were retained, but were made more flexible; in particular, funds received as wage income were exempted from the withdrawal limits. In these circumstances, virtually all operations to attract time deposits or grant loans were suspended. In addition, there were interruptions in payments made through financial entities, owing to the frequent bank holidays declared in response to liquidity problems in the banks or the exchange market. The conversion of bank balances to pesos and the freeze on withdrawals led to numerous lawsuits, many of which were decided in favour of those affected. The consequent withdrawals, coupled with the gradual reduction in the size of deposits from transactions, significantly eroded bank deposits. This, in turn, prompted requests for rediscounts from the Central Bank and increased the pressure on the exchange rate. At the beginning of June, the economic authorities,

Table 2
ARGENTINA: MAIN QUARTERLY INDICATORS

	1999				2000 [a]				2001 [a]				2002 [a]
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
Gross domestic product (change from same quarter of preceding year)	-2.1	-5.4	-5.0	-0.9	-0.2	-0.7	-0.3	-1.9	-2.0	-0.6	-5.4	-10.5	-15.4
Consumer prices (12-month variation, %)	-0.7	-1.3	-2.0	-1.8	-1.0	-1.1	-0.7	-0.7	-1.0	-0.3	-1.1	-1.5	8.3
Exports (millions of dollars)	5,065	6,395	5,944	5,929	5,724	7,316	6,749	6,620	5,921	7,500	7,083	6,151	5,720
Imports (millions of dollars)	5,840	6,017	6,843	6,808	5,876	6,298	6,606	6,464	5,742	5,777	5,017	3,775	2,072
International reserves (millions of dollars)	25,296	24,753	23,436	27,362	26,186	27,375	26,285	26,491	21,924	21,082	20,584	14,546	12,780
Real effective exchange rate [b] (index: 1995=100)	89.5	90.3	89.7	90.6	91.2	90.9	90.8	89.6	90.2	87.3	87.3	88.3	165.5
Real interest rates (annualized, %)													
Deposit rate	8.2	7.9	9.8	11.7	9.3	8.8	8.4	11.2	10.2	12.8	24.3	22.3	6.2
Lending rate	12.1	10.2	12.3	15.1	12.1	11.0	10.6	15.1	14.2	21.1	37.4	…	…

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Refers to exchange rate for imports.

concerned about the gradual draining of funds from the banks, took the highly controversial step of announcing a voluntary swap of rescheduled deposits for government securities. With respect to private debt, a number of firms decided to suspend payment of their non-bank debts in foreign currency. Lacking an agreement with IMF, the government faced the difficult task of meeting its payment obligations to international lending institutions. In May 2002 it made a payment using international reserves, and its liabilities were deferred for one year.

The operation of the dual foreign exchange market was short-lived, mainly because exporters showed little inclination to sell foreign currency. In February the authorities decided to unify the market and announced that the Central Bank would intervene to moderate the currency float. The price of the dollar continued to fluctuate but tended to rise, prompting the Central Bank to curb the granting of rediscounts and place limits on banks' foreign-currency holdings; in addition, the government authorized the retail sale and purchase of foreign exchange through banking institutions by order and for account of the Central Bank. In any event, the price of the dollar continued to fluctuate, rising to 3.50 pesos by the end of May. Despite the increase in prices, the fiscal situation was undermined by a nominal fall in tax receipts due to the severe recession and the atmosphere of great uncertainty that hung over the country. In view of the sharp exchange-rate depreciation and the urgent need for resources, the government imposed duties on exports.

In view of this situation, the government came under increasing pressure, especially from the international sphere, to adopt a "sustainable" agenda, though the definition of that term was generally left open to interpretation. During the reporting period, several rounds of talks took place between the government and IMF, but did not coalesce into a specific agreement. The items discussed included the financial relationship between the federal government and the provinces, the reorganization of the banking system and the enactment of several laws, including those relating to the bankruptcy regime and economic subversion. By the end of May 2001, the government had arduously pushed through these legislative changes and had signed agreements on deficit reduction with a number of provinces, in accordance with IMF requirements.

(a) Fiscal policy

In 2001, the drop in the federal government's current income was larger than nominal GDP. VAT receipts plunged by about 20% and social security revenues, by

11%, adding to the decline recorded over the previous three years and reflecting the reduced wage bill and the smaller proportion of contributing workers. Income and property tax revenues fell by about 10%, after having risen steadily for several years. The slide in receipts was slowed by the comparatively moderate decline in revenues from taxes on fuels and on the sale of certain products, as well as the introduction of a levy on current-account credits and debits, which accounted for more than 10% of receipts in the second half of the year. This downturn in government revenue grew sharper over the year, reaching nearly 17% in the fourth quarter. In the first quarter of 2002, the decrease was of similar magnitude and was particularly steep in the case of VAT (-30%) and the income tax (-35%).

In 2001, the federal government's primary cash expenditure was further reduced, dropping to 6.5% and affecting payroll expenses, social security payments and, in particular, transfers to the provinces. Nevertheless, the lower level of expenditure was overtaken by the drop in income, which brought the federal government's primary surplus down to 0.5% of GDP (0.9% in 2000), while the debt interest burden continued to climb, reaching about 4% of GDP.

For all these reasons, the deficit continued to swell as demand for government debt quickly faded. The country-risk rating, which in February 2001 had fallen to around 700 points because of the expectations generated by the agreement with IMF, rose to 1,000 points in June. Bond prices fell off sharply in the second half of the year, in view of growing expectations of imminent default; in fact, in December the bond spread exceeded 4,400 points, making these bonds by far the highest-yielding government security in international circulation. In the final months of 2001, the squeeze on credit to the public sector gave way to strict rationing. The public sector's extreme financial hardship and operational problems generated severe tensions, which were not alleviated in 2002, despite the government's declaration of default on its debt and the currency devaluation.

(b) Monetary and financial policy

In 2001, monetary policy was plagued by increasingly complex problems attributable to the serious fiscal situation and the sudden contraction of demand for domestic assets, especially bank deposits. The accumulation of unresolved problems finally led to the collapse of the convertibility regime, while the financial system plunged into a crisis of enormous proportions, compounded by a rash of broken contracts. The financial upheaval was so dramatic that credit flows virtually dried up and even the day-to-day buying and selling of goods were affected.

The money supply dwindled rapidly in the course of 2001 (-20%); apart from the slide in demand, which resulted from the lower level of activity and the displacement of the peso by "provincial currencies", the year-end figures reflect the restrictions on the availability of funds imposed in December. Meanwhile, fixed-term deposits denominated in pesos plummeted even further (-64%) owing to the lack of confidence that the exchange-rate parity would be maintained and doubts about the solidity of the banks, which also resulted in a decline in foreign-currency deposits. The erosion of deposits became particularly acute in November, when it turned into an all-out run. In view of this behaviour and public-sector pressure on the local credit market, as credit from outside sources became unobtainable, bank loans to the private sector fell by almost 20%, while the incidence of default increased.

The Central Bank, which until December 2001 was required to meet unconditionally the excess demand for foreign exchange at the fixed parity, had to respond to large-scale requests for funds from the public sector and from banks. The strain that this generated was clearly reflected in the operations of the monetary authority. During the year, Central Bank loans to the government increased considerably, by about 13 billion pesos, equivalent to the same figure in dollars; meanwhile, the copious financing provided to the banks took the form of rediscounts and the reduction of liabilities with those entities. The expansion of domestic credit and lower demand for money combined to cause a steep fall in the Central Bank's reserves and foreign exchange holdings, despite the injection of funds from IMF credits.

In the initial months of 2002, monetary and financial conditions suffered serious shocks. The pressure caused by fiscal problems and the steady erosion of deposits boosted money creation, while the authorities tried to shore up the peso by selling foreign exchange, with the result that reserves declined by about US$ 2 billion in the first quarter. Money in circulation rose by almost 30% during that time; over the same period there was a substantial increase in current and savings account deposits due to the authorization of the partial conversion of fixed-term deposits, though a large proportion of those assets remained in the banks merely because of the restrictions on withdrawals. The fact that much of the demand for deposits was clearly not voluntary stirred doubts about the feasibility of controlling the money stock and about the prospects of the foreign-exchange market.

The behaviour of the banking system also generated great uncertainty as to its possible future performance. Until the last few months of 2001, differences were observed in the demand for deposits with different banks (a "flight to quality deposits") and some institutions turned to external funds in order to maintain liquidity. As the crisis deepened, and after convertibility was suspended, the population's unease and lack of confidence with regard to the banks spread to the entire system. Foreign-owned banks proved unwilling to provide resources for the return of deposits, dashing the hopes raised to that effect, and in some cases they openly expressed doubts as to whether they would remain in the market. Meanwhile, the official banks were in a difficult situation, partly because of their extensive portfolio of loans to the government. Faced with the possibility that the main locally-owned bank might close, and fearing that the ensuing disturbances would be even greater than the previous ones, the authorities coordinated an operation to build up the institution's liquidity, which was accompanied by a change in its administration. In any case, the configuration of the financial system continued to be a matter of great uncertainty.

3. The main variables

In 2001 the recession became more serious, as nominal prices, which had begun to slip in 1999, continued to fall. The shrinking credit supply, the downward revision of future income forecasts and the decline in GDP helped to reduce domestic expenditure, particularly on investment, while the demand for external assets from the private sector rose considerably. In the initial months of 2002 prices changed direction again, with rather substantial increases, while the disturbances affecting the credit system further aggravated the recession and the contraction in employment, in addition to delaying the response of tradable goods-producing sectors, in which relative prices suddenly rose. The sharp decline in imports significantly increased the trade surplus, but reserves were lower, even though the public sector, and probably part of the private sector, was not making external debt repayments, meaning that the large outflow of private capital had not abated.

(a) Economic activity

The 4.5% drop in GDP in 2001 brought the cumulative decline in output to 8.5% over three years; in 2002, GDP is expected to fall by well over 10%. The recession deepened in the course of 2001: while GDP dipped by less than 2% in the first quarter, it took a dive of more than 10% in the final quarter. Throughout the period there was a strong contraction in capital formation (-16%), which pushed the investment ratio down to about 15% (compared to 21% in 1998). Private consumption was down by 5.8%, with most of the decline concentrated in the demand for durable goods. The volume of goods and services exports remained at levels similar to those of the preceding year, while imports fell off by nearly 15%.

The contraction in GDP primarily affected the sectors that were most sensitive to fluctuations in domestic demand and to credit market conditions. Specifically, construction slid by 12%, thereby accumulating a 21% slump since 1998, while manufacturing fell by 7.5%, accumulating a 19% decline over the past three years. Services experienced a more moderate contraction, and the primary sectors were able to increase their production slightly.

The grain harvest again expanded in the 2000-2001 season, reaching 67 million tons and exceeding its previous peak level. The rise was concentrated in oilseeds, especially soybeans, whose production grew by 32% as both the area sown and the yield increased. In contrast, the sunflower harvest declined significantly. In the case of cereals, there was a moderate increase in wheat production, offset by decreases in maize and sorghum. In cattle-raising, stocks were replenished as slaughter volume declined, as did relative prices in the sector. Cattle-raising was also affected by the export restrictions imposed following an outbreak of foot-and-mouth disease, although progress was made during the period both in treating the disease and in reopening markets. The currency devaluation in 2002 triggered a sharp increase in the prices of agricultural products, but the sector was still burdened by export duties, the higher cost of inputs and credit problems. In any case, the size of the current season's harvest is expected to be similar to that of the previous one.

The recession in the manufacturing industry in 2001 was fairly widespread; the only sectors that increased their output were chemicals and paper and paperboard. The decline in the automotive sector was particularly steep (30%), as the volume of output dropped to just over half the level recorded three years earlier; output also declined in other durable consumer goods and equipment sectors. Downturns were also observed in the iron and steel industry, aluminium refining, food products and, especially, textiles. The worsening of the slump in aggregate industrial output in 2001 was reflected in negative growth of close to 15% in the fourth quarter. In the first quarter of 2002, the contraction became so severe that output figures were more than 10% lower than their 1993 levels.

(b) Prices, wages and employment

At the end of 2001 there was an abrupt turnaround in price fluctuations. Until then, the CPI had continued to exhibit deflation (of 1.5% over the year), for a cumulative total of 4% since the end of 1998. After the devaluation, prices took a definite upturn, though it was much less marked than the rise in the exchange rate. The considerable increase in tradable goods prices had a palpable impact, and the resulting uncertainty prompted goods suppliers to take precautionary steps. However, slack demand and the impact of price rises after the long period of price stability that still served as a reference point had a dampening effect. Price increases progressively snowballed: hikes in the CPI amounted to 2.3% in January and over 10% in April, but fell back to 4% in May, resulting in a cumulative total of 25% over the first five months of the year. In any case, at mid-year it was still unclear how the new pattern of price fluctuations would pan out.

In 2002 there were sudden changes in relative prices. Specifically, wholesale prices jumped by about 60% in the first four months –three times faster than the CPI–, with even more pronounced increases in the case of agricultural products (almost 80%) and, especially, imports (150%). Not all the sectors considered in the CPI followed the same pattern: some showed large increases (durable consumer goods, some food items and medicines), whereas others, including some services, changed only slightly. One noteworthy phenomenon was the substantial increase in the real exchange rate, which, by May, had risen by about 200% in relation to its value at the end of 2001 and had reached a level similar to those recorded during the bout of hyperinflation experienced in Argentina in the first few months of 1990. Apart from the different speeds at which the exchange rate and prices are moving up, this behaviour reflects the very high demand for foreign exchange and the low level of expenditure on goods.

Against a background of very weak labour demand, in 2001 nominal wages experienced a slippage that exceeded 2.5% in the manufacturing industry. In the initial months of 2002, real wages fell significantly, in the absence of pay adjustments. In urban areas, unemployment increased substantially in 2001, reaching some 18.5% by October, and it appears to have risen still more sharply in 2002.

(c) The external sector

The current-account deficit dropped to about US$ 4.4 billion in 2001, which is equivalent to half the preceding year's level and represents a contraction of 70% since 1998. This was due to a 20% reduction in goods purchases abroad, which was partially offset by the larger negative balance (more than US$ 8 billion) of the financial services account. For the first time since the early 1990s, there was an outflow of capital, which in this case amounted to US$ 4 billion; the capital account shrank by more than US$ 13 billion compared to its 2000 level and by US$ 22.5 billion (more than 8% of 2001 GDP) compared to its 1998 level. In 2001, international institutions extended net credits of more than US$ 11 billion, which is more than 2.5 times the current-account deficit. The banking sector and the Central Bank received a total of US$ 3.5 billion, yet the public sector made provision for a net bond payment of US$ 5 billion. Direct investment flows dwindled considerably, from net inflows of US$ 10.6 billion to US$ 3.3 billion in 2001; in this situation, private-sector capital movements had a decisive influence, as more than US$ 17.5 billion in private capital flowed out of the country.

The value of merchandise exports was slightly higher in 2001 than in 2000 owing to a volume increase of nearly 5%, which was partially offset by price decreases. Sales of livestock products dropped by over 20% because of faltering external demand for Argentine beef following the outbreak of foot-and-mouth disease. In contrast, exports of agricultural products and derivatives were up by 5%, with notable increases in shipments of soy products (soybeans, soybean oil and by-products). Sales of non-traditional manufactures rose slightly, attaining a level of around US$ 10 billion.

The decline in imports in 2001 was especially steep in the case of capital goods (-29%), though purchases of intermediate and consumer goods also fell considerably. Imports nose-dived in the first quarter of 2002 owing to the combined effects of the sharp real devaluation, plunging local demand, serious domestic financing problems and the retrenchment of external supply as a result of the cessation of payments. In fact, imports were down by 60% in relation to the same period of 2000 and reached levels not seen since the beginning of the 1990s. As exports remained largely unchanged, this generated a very large trade surplus equivalent to about 10% of GDP.