ARGENTINA

1. General trends

After slowing rapidly in 2009, the Argentine economy resumed robust growth in 2010, with a rate well above the regional average at 9.2%. On the back of this the unemployment rate came down from 8.4% in the last quarter of 2009 to 7.3% a year later. For the first quarter of 2011, the monthly economic activity estimator (EMAE) showed year-on-year GDP growth of 9.9%, which will provide a growth floor of 6.1% for the rest of the year.

The government has leaned towards maintaining the economic stimulus on both fiscal and monetary fronts, as a result of which GDP growth may once again outperform the regional average and exceed 7.0% in 2010 if current regional and international conditions hold steady. If these growth projections are borne out, unemployment should fall yet again in 2011, although this will depend on the employment elasticity of GDP —which has been relatively limited in the last few quarters by comparison with recent years— as much as GDP growth.

Inflation was higher in 2010 than in 2009, topping the regional average. The higher rate reflected a combination of factors, including rising international commodity prices, particularly for beef, and an uptick in the nominal exchange rate amid burgeoning aggregate demand. The inflation rate for 2011 is likely to be similar to the rate for 2010 if international commodity prices, especially for foodstuffs, remain at their current levels.

The trade and current account balances both ran surpluses in 2010 (3.3% and 1.0% of GDP, respectively) and the capital and financial account registered a small net inflow. The surpluses on the current account and the capital and financial account contributed to a build-up of US$ 4.222 billion in international reserves, which stood at US$ 52.132, or the equivalent of 14.1% of GDP, at the end of 2010.

2. Economic policy

The expansionary policy adopted in 2009 was maintained in 2010 on both the fiscal and monetary fronts and this, together with economic growth in Argentina's main trading partners and an upturn in the agricultural sector after a year of severe drought, helped drive the economy's strong growth.

In the fiscal sphere, higher spending had an expansionary impact notwithstanding the improvement in the public sector balance. Both income and expenditure rose above the nominal rate of GDP growth in 2010.

Monetary and exchange-rate policies continued to be based on a dirty float targeting external and exchange-rate equilibrium, which required heavy intervention in the foreign-exchange markets given improving terms of trade and some re-entry of capital from abroad. This intervention pushed the nominal exchange rate up slightly, but not enough to prevent currency appreciation in real terms. Given that economic growth in 2010, at 9.2%, was well above the 2.5% projected in the year's monetary programme published at the end of 2009, monetary aggregates expanded much faster than the rate originally calculated by the central bank, which was forced to update its monetary targets accordingly for the second half of the year. Interest rates came down in both nominal and real terms throughout 2010.

With regard to public debt management, the government's ability to meet its external liabilities from reserves enabled it to maintain an expansionary fiscal stance despite the virtual closure of voluntary credit markets to Argentina. In addition, the debt-swap scheme the Government of Argentina had made available in early 2005 following the default in late 2001 was re-opened for bondholders who had held out during the original offer. The debt-to-GDP ratio decreased steadily in 2010 to stand at around 45.8% at the end of the year. Argentina's sovereign risk rating also eased down somewhat, but is still considerably higher than that of other countries in the region.

In the sphere of industrial policy, the non-automatic import licensing regime was extended, in particular for consumer goods with domestically produced alternatives. In 2010 the central bank and the Ministry of the Economy and Public Finance launched a bicentenary production financing programme for a total of over US$ 2 billion (0.5% of GDP), aimed at increasing long-term financing for enterprise.

In the area of social protection, 2010 was the first full year of application of the universal child allowance created in the last quarter of 2009. This is a non-contributory subsidy extended by the National Social Security Administration (ANSES) and may be claimed for all children up to the age of 18 whose parents are unemployed or informally employed, subject to certain health-care and school attendance requirements. The scheme covered some 3.5 million children in 2010.

One of the policy decisions taken by the government at the start of 2011, was to once again draw down international reserves to meet external public debt commitments, this time for US$ 9.678 billion (2.6% of GDP). On the social front, the government implemented a complementary policy extending the universal child allowance to expectant mothers.

(a) Fiscal policy

Primary public spending expanded by 33.9% in 2010 and was associated mainly with transfers to the private sector in the form of social protection instruments and subsidies to public utilities.

Social security spending reflected the full implementation of the universal child allowance, at a fiscal cost of 0.5% of GDP. In addition, the law on pension fund mobility, which came into effect in 2009, led to a rise of 16.9% in pensions in 2010. This, together with a 20.4% hike in the minimum pension decreed by the executive, swelled spending on social security benefits by 28.6%.

Capital expenditure rose in line with total spending and continued to represent around 3.0% of GDP after receiving a strong boost in 2009 from the fiscal stimulus implemented to soften the impacts of the crisis.

The bulk of the spending increase was financed from tax revenues, which were up by 37.3% over 2009. Two other factors helped to facilitate these public sector outlays: refinancing of the national treasury's liabilities vis-à-vis the rest of the national public sector and the drawdown of international reserves to meet external public debt obligations. This last measure was managed through the issue of non-transferable debt securities bought by the central bank for US$ 6.569 billion (1.8% of GDP).

As a result of the sharp rise in tax receipts, the tax burden posted an all-time high of 33.9% of GDP. As well as the economic upturn, this has to do with higher revenues from export duties, which rose on the back of higher international prices and larger export volumes. Other significant components were transfers of profits from the central bank and the ANSES sustainability guarantee fund, which together represented 2% of GDP.

The higher tax take led to a slight rise in the primary surplus, from 1.5% of GDP in 2009 to 1.7% in 2010, and an improvement in the overall balance from a deficit of 0.6% of GDP in 2009 to a surplus of 0.2% in 2010.

As a proportion of GDP, public debt came down from 48.8% in 2009 to 45.8% in 2010, despite the nominal increase associated with fresh bonds (US$ 4.053 billion) issued as part of the scheme to reopen the defaulted bond swap. Of total national public debt, only 38.5% is held by the private sector; most (46.8%) is held by other public sector agencies.1 In GDP terms, only 17.6% of national public debt is in private hands. Although Argentina's sovereign risk rating decreased significantly in 2010 compared with 2009, it still far exceeds that of most other countries in the region. Argentine public debt securities ended 2010 with a spread of 490 basis points over equivalent United States treasury bonds, whereas the average spread for the region was just 244 basis points, according to the emerging markets bond index (EMBI+).

(b) Monetary and exchange-rate policy

With international conditions highly liquid in 2010, Argentina continued to operate a dirty float exchange-rate regime, which required heavy intervention in the foreign-exchange market, resulting in a slight nominal depreciation of the peso. The rise in the nominal exchange rate was minor, however, in relation to domestic price movements, and the peso appreciated somewhat in real terms, especially in relation to the dollar. Nevertheless, the peso's appreciation was offset by currency appreciation in Argentina's main trading partners, especially Brazil.

Monetary aggregates expanded in line with nominal GDP growth in 2010, consistently with their behaviour in previous years. The average M1 balance expanded by 24.1% in 2010 with respect to 2009, while the M2 average —the aggregate used by the central bank as a benchmark for its monetary programme— increased by 28.6% in the same period. The rise in M1 and M2 balances quickened in the second semester reflecting, in part, the low levels recorded in 2009 in mid-crisis and more robust credit growth in 2010. Consumer credit, in particular, registered year-on-year growth of 37.7% at December 2010.

After the financial turmoil of 2009, local-market interest rates began to ease down. Already in early 2010 nominal rates on fixed-term deposits were two percentage points down on the year-earlier period. This downtrend continued for the rest of 2010, bringing interest rates down by over 200 basis points from 11.7% to 9.3% over the year. The central bank facilitated the drop in interest rates by lowering the rate paid on its main sterilization instruments: central bank bills and notes (LEBACs and NOBACs) and passive swap operations ("pases").

3. The main variables

a) Economic activity

GDP expanded by 9.2% in 2010, driven by all components of aggregate demand. The greatest stimulus came from consumption, both private (up 9.0%) and public (9.4%). A range of conditions influenced households' consumption decisions. First was the recovery of the labour market and an increase in household income, not only from wages but also from the social security and social protection system. Second was the brightening international economic outlook, particularly in the country's main trading

[1] The remainder corresponds to debt owed to international agencies and pending commitments to the Paris Club.

partners and especially Brazil. And third was an expansion in lending, although this factor remains secondary in the Argentine economy, owing to the small weight of domestic credit as a source of financing for private spending (around 13% of GDP).

Domestic gross fixed investment rose 21.2% to represent 22.8% of GDP, slightly below the historic high of 23.1% posted in 2008. Construction expanded by 8.2% and investment in durable equipment climbed 41.1%.

Exports rose by 14.6% in the largest real increase since the mid-1990s. The strength of this performance was chiefly a reflection of the low basis for comparison, given the drought during the 2008/2009 crop season. Imports substantially outperformed exports in real terms, with a surge of 34.0%.

Among the goods producing sectors of the economy, agriculture in particular stands out and posted a robust recovery after the drought of 2009. The sector overall expanded by around 30% in 2010, despite a decrease of 10% in cattle stock to 48.9 million head. This was the second consecutive year of declining stocks, this time at an even faster rate (5% in 2009). After successive declines, cattle stocks are now similar to those of 2001-2002 and the lowest in 20 years, and the 2010 beef slaughter was down by 27% on 2009. The decline in stocks and diminished beef production, together with the rise in international beef prices, helped to push up the price of cattle on the hoof by over 100% on average.

Industrial output expanded strongly in 2010, showing year-on-year average growth of 10%. Most manufacturing sectors regained pre-crisis activity levels. The automobile industry in particular rebounded strongly (41%) after taking a severe hit in 2009. Total automobile production surpassed 715,000 units, which was an all-time record. Of these automobiles, 62.5% were exported and of these exported units 84.6% went to Brazil. Basic metal manufacturing expanded 22% and textile production, 15%. Petroleum refining and paper and paperboard were among the segments of industry which registered no growth at all or failed to recover pre-crisis levels.

(b) Prices, wages and employment

Two factors fuelled inflationary expectations in the first quarter of 2010 and produced a direct impact on wage negotiations. One was the sharp upswing in international commodity prices and their heavy impact on costs of resource-based domestic production, especially in the context of an exchange-rate policy which, diverging from practice in other countries in the region, has sought to avoid nominal currency appreciation even during terms-of-trade upturns. The other factor was a steep rise in the local price of beef, which is highly influential in the Argentine consumer basket.

The quickening of inflation in the early months of 2010 was contained in the second semester. Even so, the combination of rising international commodity prices, particularly for foodstuffs (17.2% in the course of 2010, according to data from the Food and Agriculture Organization of the United Nations), a higher nominal exchange rate (5.0% in the same period) and an average wage hike of over 20% pushed inflation above both the 2009 rate and the regional average for the year.

In the labour market, the fall in unemployment in 2010 was due partly to the economic upturn, as well as a fall in the participation rate, which dropped from an average of 59.3% in 2009 to 58.9% in 2010. After rising in 2009, unemployment decreased slowly but steadily throughout 2010. By the end of the year, it had reached the lowest rate for the last 20 years, although the manufacturing sector still fell short of generating the levels of employment and hours worked seen in 2008 before the international crisis struck.

The outcome of annual wage negotiations was an average hike of 22.5% in the general wage level. Registered private sector workers secured a gain of 24.8%, outstripping the rise for unregistered private sector workers and civil servants. Workers in the manufacturing sectors were able to negotiate a wage increase well above the general average, at 32.7%. The minimum wage was raised early in the year, by 22.7% over 2009. The setting for the wage negotiations held in the first semester of 2011 was less pressured than in 2010, mainly thanks to the easing of food price inflation. Yet the negotiations concluded thus far are tending towards increases of over 20% this year as well, which could indicate the institution of a price-wage dynamic that may bode poorly for the economy's external competitiveness.

(c) The external sector

Demand for imports in 2010 was heavily driven by burgeoning domestic absorption and some real currency appreciation. Nevertheless, the trade balance and current account both returned surpluses (3.3% and 1.0% of GDP, respectively), largely owing to the recovery in agricultural exports. Continued rapid growth and further real currency appreciation will have a heftier impact on the external accounts in 2011, since the upswing in agricultural exports of 2010 is unlikely to be repeated.

Turning to the merchandise trade balance, export values were up by 23.0% in 2010, reflecting both higher prices (5.3%) and —especially— an upturn in volumes (16.8%), particularly of primary products and industrial manufactures (55.0% and 24.6%, respectively). Industrial manufactures represented their largest ever proportion of Argentina's trade structure in 2010, at 35.1% of all exports, although the manufacturing sector overall ran a trade deficit. Exports continued to expand in the first quarter of 2011, posting a cumulative variation of 31% (15% by price and 14% by volume).

Good imports surged by 45.5% in 2010 (5.7% by price and 37.7% by volume). The fastest-growing categories were motor vehicles (up 80%), fuels (70%) and parts and accessories for capital goods (52%). The GDP elasticity of total imports rose to 3.7%, the highest figure since 2005. Imports showed another powerful surge in the first quarter of 2011—of 40% over the year-earlier period.

Trade in real services returned a deficit that was relatively small compared with the pattern of recent years. Growth in services exports reflects incoming tourism and the buoyant performance produced in the last few years by exports of business, professional and technical services.

The structural deficit Argentina has been running on its investment income account reached US$ 10 billion in 2010, 11.1% larger than in 2009 but virtually unchanged in relation to GDP.

Unlike in 2009, in 2010 the capital and financial account showed a small net capital inflow (US$ 700 million), although this has tended to dissipate in early 2011. Foreign direct investment surged by over 50% in 2010 with an inflow of US$ 6.2 billion, of which 40% corresponded to reinvested earnings. A comparison with other periods shows that reinvested earnings accounted for some 13% of foreign direct investment on average in the 1990s, but as much as 23% in 2004-2008.

The surpluses on the current account and the capital and financial account contributed to a build-up of US$ 4.222 billion in international reserves in 2010, which took holdings to US$ 52.132 billion, or the equivalent of 14.1% of GDP, at the end of 2010.