

Argentina

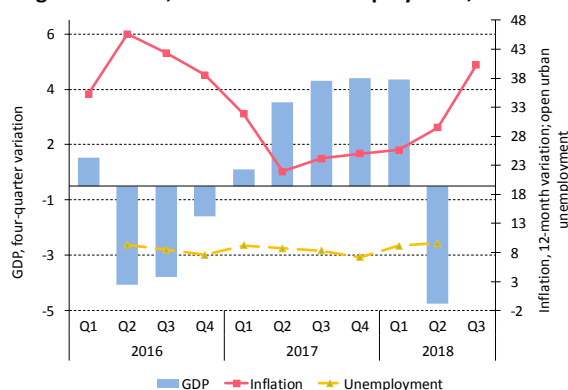
Economic activity in Argentina contracted in 2018, following the previous year's 2.9% expansion. At the same time, inflation surged to 45.9% year-on-year in October, compared to the 25% recorded in late 2017. This dynamic was marked by the currency crisis of the second and third quarters of the year, which entailed a sharp devaluation of the peso, a pronounced interest-rate hike, accelerating inflation and a substantial drop in real family incomes. These episodes, which led to a request for financial assistance from the International Monetary Fund (IMF), unfolded against an adverse external backdrop involving a rise in interest rates on United States treasury bonds and a hike in energy prices. This was compounded by certain local vulnerabilities associated with a large current account deficit, a severe drought that ravaged the agro-export sector, and the accumulation of short-term debt held by the Central Bank of the Argentine Republic (BCRA) with the private sector. Most of the negative impact of these tensions on consumption and investment, along with the contractionary effect of the fiscal and monetary policy committed to under the arrangement with IMF, are likely to be felt in the last four months of 2018, with GDP set to end the year down by 2.6%.

For 2019, a slight recovery in real family incomes is expected, along with a better agricultural harvest and continued growth among Argentina's trading partners, which will tend to stimulate private consumption, investment and exports. Nonetheless, contractionary fiscal and monetary policies are also likely to be maintained. In this scenario, and considering the high negative statistical carry-over from 2018, a 1.8% reduction in GDP is projected for 2019, assuming no new sources of tension arise in the external sector of the economy.

Fiscal policy adopted a contractionary stance in 2018. The primary deficit fell to a cumulative 1.2% of GDP to October (from 2.4% in the year-earlier period), as a result of primary expenditure increasing by less (21.4%) than income (29.9%) year-on-year. In real terms, primary expenditure and income both declined. After the payment of interest on the debt, the fiscal deficit stood at 3.4% of GDP, compared to the 4.1% recorded in the same period of 2017. If other public investment expenses are considered (Priority Investments Programme), in keeping with the methodological criterion used by IMF to monitor the goals of the financing programme arranged with the Argentine Government, the cumulative primary deficit to October amounts to 1.5% of GDP. In contrast, the national public sector debt jumped sharply from 57.1% of GDP at end-2017 to 77.4% June 2018. This reflected the new financial liabilities contracted during the year to finance the deficit, compounded by the accounting effect of the higher exchange rate on the peso value of foreign-currency-denominated debt.

Given the fiscal deficit financing needs and the goal of strengthening international reserves in a situation of difficult access to international credit, the Argentine Government agreed a stand-by arrangement with IMF for a loan of US\$ 56.3 billion covering a period of 36

Argentina: GDP, Inflation and Unemployment, 2016-2018



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

months. Although the original agreement was reached in June, heightening exchange-rate tensions required a new arrangement to be negotiated in September. The revised agreement included an increase in the total amount of the loan, an acceleration of the disbursement schedule, and changes in fiscal, monetary and foreign-exchange policy commitments. The renegotiation specifies total disbursements for 2018 of US\$ 28.4 billion, followed by US\$ 22.8 billion in 2019, with the remainder to be released in 2020 and 2021. The fiscal policy committed to in the arrangement includes the goal of attaining primary fiscal balance by 2019, to be achieved by real cuts in public expenditure on subsidies (energy and transport), public sector wages, transfers to the provinces and public investment. The stand-by arrangement includes the possibility of increasing social spending if necessary. This clause was activated when two reinforcement bonuses were paid to the beneficiaries of the Universal Child Allowance (AUH) programme in September and December 2018, following the surge in inflation.

On the fiscal front, and linked to the arrangement with the IMF and approval of the 2019 budget, export withholding taxes were introduced at a fixed rate in pesos, equivalent to a tariff of 11% for commodities (29% for soybeans) and 8% for other products (at the average exchange rate prevailing in October). This is expected to generate additional resources equivalent to approximately 1% of GDP in 2019. An additional strand of the policy to reduce the fiscal deficit included a bill sent to Congress to increase the non-taxable minimum income threshold and establish a schedule of progressive rates for the tax on personal assets or wealth (thereby reversing its elimination, which had been scheduled for 2019), and to update the criteria for revaluing company balance sheets, which in practice enlarges the corporate income tax base.

In the context of heavy pressures for a devaluation of the peso, in 2018 the central bank's policy focused on exchange-rate stabilization by tightening the already contractionary stance of monetary policy and by intervening actively in the foreign-exchange market. Between the second and third quarters of the year, BCRA sharply hiked its policy interest rate (to an annual nominal rate of 60% in September); it also sold US\$ 13.9 billion in international reserves and validated a 103% rise in the nominal exchange rate between end-March and end-September. In a complementary manner, it also raised the reserve requirement on peso deposits, lowered the limit on bank holdings of foreign-currency assets and made specific interventions in the dollar futures market.

In late September, the central bank made a number of policy changes while renegotiating the terms of the stand-by arrangement with the Fund, which helped to dissipate exchange-rate instability. The key change in monetary policy involved abandoning the inflation targeting regime (put in place in January 2017), and replacing it with monetary aggregate targeting. In this framework, the target was zero nominal growth of base money until June 2019. This new approach is implemented through daily transactions in Liquidity Bills (LELIQs) with the banks, together with adjustments to minimum liquidity requirements. In practice, this means a sharp contraction of the real money supply, in conjunction with

Argentina: main economic indicators, 2016-2018

	2016	2017	2018 ^a
	Annual growth rate		
Gross domestic product	-1.8	2.9	-2.6
Per capita gross domestic product	-2.8	1.9	-3.9
Consumer prices ^b	38.5	25.0	45.5 ^c
Money (M1)	20.2	29.4	26.0 ^d
Terms of trade	6.2	-2.9	-4.6
	Annual average percentage		
Open urban unemployment rate ^e	8.5	8.4	9.4 ^f
Central government			
Overall balance / GDP	-5.8	-5.8	-5.6
Nominal deposit rate ^g	24.4	19.1	26.8 ^d
Nominal lending rate ^h	33.3	26.8	40.3 ^d
	Millions of dollars		
Exports of goods and services	70 732	72 642	76 481
Imports of goods and services	74 496	88 076	86 105
Current account balance	-14 693	-31 324	-25 201
Capital and financial balance ⁱ	29 004	45 880	23 134
Overall balance	14 311	14 556	-2 067

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

a/ Estimates.

b/ As from 2017, the data are matched with those corresponding to Gran Buenos Aires; in order to make an interannual comparison.

c/ Figures as of October.

d/ Figures as of September.

e/ Data are therefore preliminary and will be replaced when new official data are published.

f/ Figures as of first semester.

g/ Fix term deposit rates.

h/ Local-currency loans to the non-financial private sector, at fixed or renegotiable rates, signature loans of up to 89 days.

i/ Includes errors and omissions.

high interest rates (the annual nominal yield on LELIQs averaged 68.1% between October and November). The risks of this policy include a potential increase in private sector financial fragility, as a result of tighter conditions for accessing bank credit, as well as the erosion of the overall balance of the central bank. On the other hand, it was decided to continue with the programme of retiring Central Bank Bills (LEBACs), the accumulation of which in short-term tranches by the private sector had been one of the triggers of the currency crisis. The policy aim is to persuade the banks to migrate to the new instruments (LELIQs) and become the only holders of BCRA securities.

On the exchange-rate front, the central bank established a non-intervention exchange-rate band of between 34 and 44 pesos per dollar, to be adjusted daily at a rate of 3% per month until the end of the year. When the exchange rate moves above this range, the central bank will make daily sales of up to US\$ 150 million; and when the rate drops below the range it will be able to intervene as a buyer. In the first quarter of 2019 the bounds of the non-intervention band will be updated daily at a monthly rate of 2% based on the limits prevailing on 31 December 2018 (a range of 37.1 to 48 pesos per dollar).

In the first half of 2018, the cumulative four-quarter deficit on the current account of the balance of payments grew to one of the largest on record, at 5.6% of GDP, owing to larger shortfalls on the goods, services and income accounts. The widening of the merchandise trade gap reflected the fact that year-on-year import growth (12.9%) outpaced that of exports (5.5%). Imports classified by economic uses increased generally; while exports also expanded, driven by industrial manufactures (up 12.8% year-on-year) and fuels and energy (77.5%). Commodity exports fell back (-5.5% year-on-year) as a result of the drought that diminished the soybean and maize crops. The services trade deficit also widened to 1.7% of GDP in the first half of the year (cumulative over four quarters), mainly due to an increasingly negative balance in tourism and travel, which widened by 10.1% year-on-year in the first half of the year. Meanwhile, the income account deficit grew to a cumulative 2.8% of GDP (annualized over the first six months), driven by larger net outflows of portfolio investment income (by 52.1% year-on-year).

The capital and financial account posted a cumulative four-quarter surplus of 7.9% of GDP in the first half of the year, mainly owing to general government debt (6.8% of GDP) and foreign direct investment (FDI) (1.8% of GDP). Foreign currency outflows motivated by hoarding partially offset this surplus with a cumulative four-quarter deficit equivalent to 3.6% of GDP. With the capital and financial account surplus outweighing the deficit on the current account, Argentina's international reserves grew by the equivalent of 2.1% of GDP year-on-year.

The dynamics of the external sector experienced a trend break between the second and third quarters of the year, owing to the foreign-exchange crisis. During that period, the net demand on the central bank's foreign-exchange balance sheet, motivated by hoarding and non-residents' portfolio investments by rose sharply to US\$ 23.3 billion (3.7% of GDP), of which US\$ 12.7 billion was absorbed by a drain on international reserves (2% of GDP). On the other hand, the peso devaluation, in conjunction with the third-quarter economic downturn, caused the merchandise trade deficit to shrink by 36% year-on-year and the services deficit (BCRA foreign-exchange balance sheet) to narrow by 38.6%, in both cases owing mainly to lower expenditure. An extrapolation of this trend would suggest that the current account deficit in dollars will be smaller in 2018 than in the previous year.

Economic activity shrank by 0.5% year-on-year in the first six months of 2018, driven by negative contributions from agriculture (-2.2%) and from transport and communications (-0.1%), in the context of the drought that undermined the soybean and maize harvest. On the demand side, the fall was explained by negative contributions to growth made by imports (-2.4%), public consumption (-0.2%) and exports (-0.2%). This situation was partially offset by positive contributions from private consumption (up 1.7%) and by investment and the variation in inventories (up 1.8%). The real

magnitude of the devaluation's adverse impact on consumption and investment will only be revealed when the figures for the third and fourth quarters of the year are released. According to the available information, the activity slowdown accentuated in the second half of the year: the Monthly Estimator of Economic Activity (EMAE) published by the National Institute of Statistics and Censuses (INDEC) was down by 1.5% year-on-year in September; and the Monthly Industrial Estimator (EMI) was 2.5% lower in October than a year earlier.

Inflation gathered pace to reach 31.2% year-on-year in October (compared to an average of 25.5% in 2017), as a result of the peso devaluation, a public utility rates hike and the rise in the international oil price. The INDEC wage index rose by a nominal 23.9% year-on-year to September, but was down by 4.3% in real terms. In particular, wages in the registered private sector fell by 3.8% in real terms, those of the public sector fell by 5.3%, and those of unregistered private workers dropped by 4.4% in the same period year-on-year. In October, the minimum pension stood at 8,637 pesos (US\$ 233), and the minimum wage was 10,700 pesos (US\$ 288). In October, pensions were down by 6.2% year-on-year in real terms and the minimum wage had lost 10.5% of its purchasing power. The surge in inflation means that wages, pensions and the minimum wage will lose even more of their real value by end of the year.

The unemployment rate in the second quarter of 2018 was 9.6% —0.9 percentage points higher than a year earlier, in the context of a 1 percentage point rise in the labour force activity rate. The increase in joblessness affected women and young people of both sexes the most. In the largest urban areas (Córdoba and Greater Buenos Aires), unemployment was above two-digit levels.