Argentina

Economic activity expanded considerably for the fourth year in a row, with GDP growth estimated at 8.5% in 2006. All the components of demand grew considerably, but the expansion was even greater in domestic absorption and, particularly, investment. Consumption climbed notably, but in line with GDP, and the domestic saving ratio therefore remained well above levels recorded during the 1990s. Despite a slowdown in the growth of export volumes, the trade balance posted a considerable surplus (similar to that of the previous year) thanks to higher international prices for some products and reduced import elasticity relative to domestic demand. As a result, the balance-of-payments current account was strongly positive once again. Although public expenditure rose sharply, tax receipts were robust enough to generate a primary surplus of over 3% of GDP for the consolidated public sector, despite smaller balances in provincial jurisdictions. Social indicators relating to poverty and indigence continued to improve, again on the strength of rising employment (which outpaced the increase in the labour supply) and higher real wages. The rise in inflation had been a cause of public concern at the beginning of the year, prompting the authorities to monitor prices in sensitive sectors and to intervene in determining price levels in these areas. In fact, the rate of increase in the retail price index slowed, although the consumer price index (CPI) for unregulated items and the GDP implicit price index maintained the same rate of increase as the year before.

In what is clearly still an expansionary macroeconomic context —with projected growth of around 7.5% for 2007— and now that the country has fully recovered from the deep crisis of the early part of this decade, Argentina may be making a transition to a period of sustained growth. In the medium term, this appears to call for measures to consolidate saving, strengthen investment (in aggregate terms and in activities that could create bottlenecks, such as the energy sector) and exports, and establish socially appropriate distribution patterns. Important shorter–term objectives are to align growth in aggregate demand and supply and to maintain the external and fiscal surpluses that have done much to provide economic policymakers with greater manoeuvring room.

During 2006, the implementation of fiscal policy was not subject to any major pressures, thanks to the steady increase in receipts. In the first nine months of the year, the current revenues of the national public sector climbed by just over 23%. Considerable increases were recorded in all tax categories, but particularly in social security contributions, which were over 40% higher owing to the rise in the number of contributors (a proportionally much greater increase than the growth seen in the population and in total employment, which reflects a growing formalization of employment) and wage hikes. This category was the source of almost 16% of total revenues (compared with 13.4% in 2005). The value added tax (VAT) and taxes on profits and assets continued to represent over half of total tax receipts (55%), while taxes on foreign trade contributed 13%. Primary expenditure climbed faster than revenues, however (28%). Public investment rose sharply, as in previous years, and capital expenditure consequently grew by more than 60%. The public-sector primary surplus remained quite hefty, although it was smaller than in 2005, partly owing to smaller surpluses in provincial accounts. The national government's financial balance was thus positive once more. In this context, the government embarked upon formal negotiations to settle its US$ 6.3 billion debt with the Paris Club, having paid off all its debt to the International Monetary Fund (IMF) at the beginning of the year.

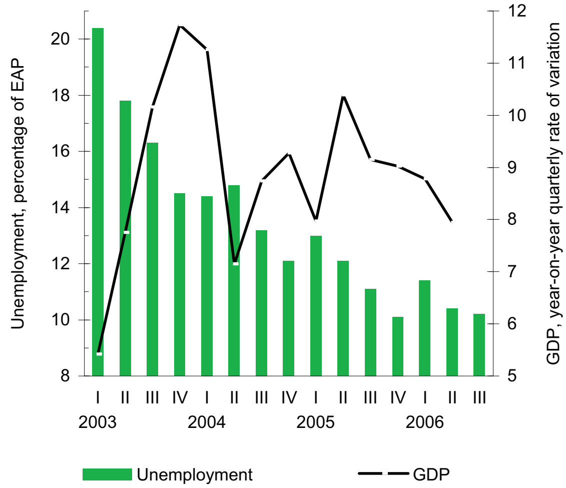
An excess supply of foreign exchange enabled the central bank to regain, in the space of just nine months, the level of international reserves recorded in December 2005 before the settlement of its IMF debt. The expansion of the monetary base resulting from the policy of intervening in the foreign-exchange market and building up reserves was partly sterilized by the central bank's bond issues, the calling in of rediscounts and loans to the government, and the increase in bank reserve requirements. All of the above helped to lower the growth rate of the money supply to below the previous year's rate, although fixed-term deposits were up steeply (by around 30%). At the same time, interest rates on central bank operations gradually rose. Be this as it may, bank credit to the private sector continued to climb sharply, with year-on-year increases of over 40%. Use of the various types of credit instruments rose across the board, but particularly in the consumer loan segment.

The volume of private consumption continued to expand strongly in line with GDP growth. Meanwhile, public consumption stepped up its pace of expansion, which nevertheless remained lower than the growth rate of GDP. Aggregate national saving easily covered investment financing requirement. Buoyant activity in public works projects and private construction, driven by steady demand (which was reflected in property prices), fuelled a strong rise in construction expenditure. Investment in durable equipment also posted considerable, albeit smaller, increases. For the year as a whole, the capital formation ratio at constant prices appears to have been in excess of 21%.

Supply expanded in both the merchandise production and services sectors, while agricultural output declined. The grain harvest was down by almost 7 million tons on the previous season, partly owing to bad weather conditions. This having been said, the 2005/2006 harvest —with its record level of soybean production and smaller harvests of the main cereals— was the second-largest ever in terms of volume. The area under soybean cultivation is expected to expand once again in the 2006/2007 season. Much larger areas will also be sown with maize and sunflower.

With international demand for beef on the rise, the authorities placed priority on supplying the domestic market. This led to price-setting agreements and the establishment

Figure 1
ARGENTINA: GROSS DOMESTIC PRODUCT AND UNEMPLOYMENT



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

of export restrictions. In the first eight months of 2006, slaughter rates, production and, above all, exports were lower than they had been in the corresponding period in 2005. Although beef consumption continued to rise, these policy measures also resulted in lower cattle prices than in December 2005.

Mining output showed little variation in 2006. Metal mining was up slightly, and this translated into higher exports, while petroleum production dropped. Developments in the hydrocarbon and energy sectors drew public attention to the issues involved in determining contractual provisions (especially with regard to price-setting mechanisms) and to investment performance, in which the public sector is becoming increasingly involved.

In the first 10 months of the year, industrial activity registered a year-on-year increase of 7.6%. This expansion took place across the board, with above-average increases in three main sectors: motor vehicle production (in response to buoyant domestic sales and exports); non-metallic minerals (boosted by construction); and tobacco (due to domestic demand for lower-price cigarettes). The use of installed capacity remained high and stable, suggesting that capacity has been built up through productive investments that have kept pace with increases in output. In the services sector, mobile telephony turned in another noteworthy performance.

Consumer price inflation slowed in 2006, partly owing to the price-setting agreements reached among authorities, producers and traders, as well as measures to discourage exports of staple goods. In the first 10 months of the year, the CPI climbed by 8% (9.8% in 2005). This was mainly attributable to slower growth in goods prices (6.5%), while, driven by sharply rising domestic demand, the prices of services continued to climb at the same rate as before (10.4%). Although there was a free-flowing supply of foreign exchange, a nominal depreciation was recorded against the United States dollar (3% in nine months). Nevertheless, the peso appreciated against that currency in real terms while depreciating by more than 8% against the euro. The real exchange rate with respect to Brazil's currency held steady.

In the third quarter of 2006, the urban employment/population ratio (41.6%) was 0.5 percentage points higher than in the same period in 2005. This paved the way for a drop in the open unemployment rate, which fell by almost one percentage point to 10.2%. Early in the year, the authorities established informal guidelines for pay hikes which were then used in wage negotiations. On average, private-sector wages (for formal and informal employment) rose by almost 15% in the first nine months (more than the 7% increase in retail prices), while public-sector wages climbed by around 10%.

The balance-of-payments current account surplus is expected to stand at around US$ 8.4 billion, which is more than 4% of GDP and almost US$ 2.7 billion higher than in 2005. In the first instance, this reflects an ample merchandise and services trade surplus that remained at much the same level as it was the year before (around 6.2% of GDP) and a smaller deficit on the income account (profits and interest), owing to the public debt restructuring undertaken in 2005, which reduced the amount of interest payments in 2006. The positive balance for capital movements in the non-financial private sector generated an excess supply of foreign exchange, which was offset by a high level of government purchasing. As a result, international reserves stood at over US$ 30.0 billion in November.

Merchandise exports are estimated at over US$ 47.0 billion in 2006, or 17% more than the previous year. This steep increase is due to both higher prices and higher volumes. Export values rose in all the various categories, but especially in manufactures. The lowest growth rate was recorded for exports of fuel and energy products as a result of a sharp drop in volumes, which was nonetheless offset by rising prices. The volume of industrial (agricultural and other) goods exports rose at well above the aggregate rate. The proportion of exports going to MERCOSUR increased (by more than 20% in 10 months), but remained much lower than the figure for the 1990s.

Merchandise imports displayed year-on-year growth of 20% in the first 10 months of the year, mainly due to increases in volume. Purchases of capital goods rose at a rate close to the average, while consumer goods overtook intermediate goods. As in previous years, imports from other MERCOSUR member countries represented a large proportion of the total (37%).

Table 1
ARGENTINA: MAIN ECONOMIC INDICATORS

	2004	2005	2006 [a]
	Annual growth rates		
Gross domestic product	9.0	9.2	8.5
Consumer prices	6.1	12.3	10.0 [b]
Average real wage [c]	10.0	6.0	9.4 [d]
Money (M1)	38.0	26.8	25.6 [e]
Real effective exchange rate [f]	4.9	0.2	2.3 [g]
Terms of trade	1.9	-2.1	4.5
	Annual average percentages		
Urban unemployment rate	13.6	11.6	10.4 [d]
National government overall balance/GDP	2.0	0.4	1.0
Nominal deposit rate	2.7	3.9	6.5 [h]
Nominal lending rate	6.8	6.2	8.5 [i]
	Millions of dollars		
Exports of goods and services	39 721	46 343	54 274
Imports of goods and services	27 939	34 916	41 161
Current account	3 446	5 789	8 473
Capital and financial account	-10 398	2 294	4 931
Overall balance	-6 952	8 083	13 404

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary estimates.
[b] Twelve-month variation to November 2006.
[c] Manufacturing.
[d] Estimate based on data from January to September.
[e] Year-on-year average variation, January to September.
[f] A negative rate indicates an appreciation of the currency in real terms.
[g] Year-on-year average variation, January to October.
[h] Average from January to October, annualized.
[i] Average from January to November, annualized.