

Argentina

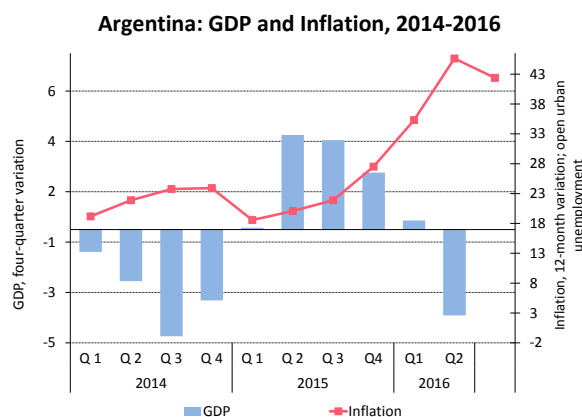
Economic activity in Argentina contracted in 2016. The first three quarters of the year saw a year-on-year fall of 2.4%, following a sharp cutback in investment, weaker household consumption and public expenditure cuts, which could not be offset by the growth in exports. At the same time, the inflation rate rose to 40.9% in the first 10 months of 2016, from an average of 26.6% in the previous year.¹

The behaviour of the Argentine economy in 2016 reflected external factors the recession in Brazil as well as domestic ones. To reverse the foreign-exchange liquidity crisis that had been hampering the economy in earlier years, in December 2015 the new government deregulated the foreign-exchange market (triggering a steep devaluation of the peso against the dollar (40% in a single day). It also eliminated export duties and quotas (except on soybeans) and implemented a tight monetary policy. In addition, the government announced the goal of eliminating the fiscal deficit within four years, mainly by reducing subsidies on the consumption of public utilities, which in 2015 were equivalent to 3.4% of GDP. In late 2015, national public administration was running a deficit of 3.8% of GDP. The resolution of the dispute with bond holdouts agreed in April, enabled Argentina to return to the international financial markets and postpone the announced reduction in the fiscal deficit, which in 2016 is expected to come in at 5.0%.

The December 2015 exchange-rate devaluation, together with the elimination of export duties and quotas, triggered an upsurge in inflation, which was stoked further by the public utility rate hikes implemented as from April. Consequently, wages, pensions and other benefits paid by the social protection system lost roughly 5% of their real value, which was not offset by the expanded coverage of family allowances. Taken together, the amounts disbursed in respect of pensions, family benefits (contributory) and the Universal Child Benefit (non-contributory) declined by about 3.3% in real terms between 2015 and 2016.

The consequent fall in the share of wages in total income, which affects the short-term trend of private consumption, compounded the reduction in investment and was not offset by trends in public expenditure or exports, since these grew only moderately. Although public expenditure played a less contractionary role in the second half of the year, the retreat of household consumption and the reduction in investment mean that the year is set to end with GDP down by 2.0%.

Although an economic recovery is expected in 2017, its intensity will depend on three factors: the trend of real family incomes, which in turn depends on the outcome of wage negotiations and determines the dynamic of private consumption; the behaviour of investment, which, among other factors, responds to the level of installed capacity utilization in the economy and the investment decisions of the public sector; and the growth rate of the Brazilian economy, given its



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

¹ Measured by the population-weighted consumer price indices of the city of Buenos Aires and the province of San Luis.

influence on Argentina's manufactured exports. Given the lacklustre growth forecast for Brazil in 2017 and the increase in idle capacity observed in 2016 (installed capacity utilization in industry was 63.9% in September), the recovery in 2017 is likely to be moderate (growth of around 2.3%) unless real family incomes are substantially restored.

On the fiscal policy front, primary expenditure growth continued to outpace income year-on-year in the first nine months of 2016 (increases of 29.8% compared to 26.8%, respectively). The resulting primary deficit represented 3.8% of GDP (up from 3.6% in the year-earlier period); and, after taking account of profits handed over by the Central Bank of the Argentine Republic (BCRA), the interest earned by the Pension Sustainability Guarantee Fund (totalling 2.9% of GDP), and interest payments equivalent to 2.2% of GDP, there was a financial deficit of 3.2% of GDP (compared to 3.3% in 2015).

In terms of primary expenditure, social security benefits and transfers to the private sector grew at above-average rates (by 38.0% and 36.6%, in that order), while capital expenditure fell (below average) by 1.4% in nominal terms. The growth of subsidies to public utility consumption slowed by less than expected (15.2% in nominal terms compared to 9.9% a year earlier), with the deceleration concentrated in the energy sector (the recipient of 70% of subsidies in 2015). On the income side, apart from the natural effect of the recession on tax revenue, export duties were eliminated, having represented roughly 0.8% of GDP in 2015. As this note went to press, the National Congress was debating various bills to amend the profits tax applicable to workers' pay.

The deficit was mainly financed by bond issues: US\$ 32 billion in foreign currency between January and October, and US\$ 8.3 billion equivalent in local currency in the same period. Consequently, the public debt, which had stood at 53.6% of GDP in 2015 (including debt with payments in arrears) grew by about 8 percentage points of GDP in 2016.

The central bank has signalled a shift in monetary policy towards a formal inflation-targeting scheme, to be in place as from January 2017. This will specify a target range of 12-17% for that year, declining in subsequent periods. In line with that decision, in 2016 BCRA sharply increased its issuance of central bank bills (LEBAC), for which the 35-day interest-rate was relatively high (33% on an annualized basis) at the start of the year, but was lowered gradually (to 25.75% in mid-November). The volume of LEBAC issuance generated a significant mass of liquidity (equivalent to 89.8% of the monetary base as of October 2016), which, in a financial context of continuing foreign-exchange outflows for financial reasons, requires the central bank to be cautious in its interest-rate normalization policy, since this could disturb the recovery of the real economy.

Together with the decision to adopt formal inflation targeting, BCRA migrated to a more flexible exchange-rate regime as from December 2015, under which the nominal exchange rate rose between January and October to about 62% above its year earlier level. Exchange-rate liberalization, the resolution

Argentina: main economic indicators, 2014-2016

| | 2014 | 2015 | 2016 ^a |
|--------------------------------------------|----------------------------------|---------|-------------------|
| | Annual growth rate | | |
| Gross domestic product | -2.5 | 2.5 | -2.0 |
| Per capita gross domestic product | -3.5 | 1.5 | -2.9 |
| Consumer prices | 23.9 | 27.5 | 42.4 ^b |
| Money (M1) | 26.1 | 31.6 | 22.2 ^c |
| Terms of trade | -2.5 | -4.3 | 4.4 |
| | Annual average percentage | | |
| Open urban unemployment rate | 7.3 | 6.5 | 8.9 ^e |
| Central government | | | |
| Overall balance / GDP | -4.2 | -3.8 | -5.0 |
| Nominal deposit rate ^e | 20.8 | 21.7 | 22.6 ^b |
| Nominal lending rate ^f | 29.3 | 28.2 | 34.4 ^b |
| | Millions of dollars | | |
| Exports of goods and services | 82,285 | 70,834 | 69,795 |
| Imports of goods and services | 79,369 | 75,146 | 72,382 |
| Current account balance | -8,031 | -15,944 | -13,270 |
| Capital and financial balance ^g | 9,226 | 11,073 | 25,239 |
| Overall balance | 1,195 | -4,871 | 0 |

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

a/ Estimates.

b/ Figures as of October.

c/ Figures as of September.

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

e/ Figures as of average of second and third quarters.

f/ Fix term deposit rates.

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

h/ Includes errors and omissions.

of the conflict with bondholders and the return to international credit markets made it possible to replenish international reserves and practically eliminate the foreign-exchange tensions of earlier years. The foreign-exchange inflow, driven by the policy on asset clean-up implemented in the second half of the year (which resulted in about US\$ 7 billion in cash entering the country), also helped stabilize the exchange rate, which, in the inflationary context described, was tending to appreciate in real terms.

The policy on asset clean-up offers a voluntary scheme to legalize holdings of national or foreign currency and other assets, either in Argentina or abroad, that have not been declared to the Finance Department, by paying a special tax at a rate of between 0% and 15% depending on the amounts in question and the date of declaration. At the same time, the tax rates on personal assets (wealth) are being gradually reduced (with elimination scheduled for 2019).

In the first half of 2016, the balance-of-payments current account accumulated a deficit of US\$ 6.693 billion (1.3% of GDP) larger than in the same period a year earlier. Nonetheless, the trade balance improved, since imports, measured in dollars, shrank more than exports (by 5.6% compared to 2.5%, respectively). Both aggregates grew in real terms (imports by 4.2%, following sharp increases in purchases of vehicles and consumer goods; and exports by 5.1%, driven by sales of commodities and their derivative products); but the prices of traded goods fell generally. In contrast, the services trade deficit widened from US\$ 1.940 billion to US\$ 2.974 billion. The current account deficit was comfortably financed by the surplus on the capital and financial account (US\$ 12.386 billion or 2.4% of GDP), thanks to income obtained through public borrowing (both national and provincial), and despite the continuing sale of foreign exchange to the private sector to build up cash balances (over US\$ 10 billion in the first three quarters).

Economic activity in January-September was 2.4% weaker year-on-year. According to data available up to the second quarter, when GDP shrank by 1.7% year-on-year, the contraction is explained by cutbacks in investment (4.2%) and the growth of imports (10.6%). When imports are subtracted from each component of aggregate demand, there is a steeper fall in investment (10.4%) compounded by reductions in both private consumption (1.0%) and public consumption (0.3%), and partly offset by export growth (2.1% in real terms). On the supply side, the reduction is explained by the decreased production of goods (5.8%), reflecting the downturn in manufacturing industry (4.6% year-on-year) and negligible growth in the services sector (0.7%).

Inflation surged from an average of 26.6% in 2015 to 40.9% between January and October 2016. The National Institute of Statistics and Censuses (INDEC) resumed publication of the Greater Buenos Aires Consumer Price Index (IPC-GBA). The new series starts in May 2016, and records a cumulative increase of 13.7% between May and October, with prices rising even faster in items such as food and beverages and medical care. Moreover, following two years without publishing data on income poverty, in September the organization published the official estimate for the second quarter of 2016, putting the rate at 32.2% of the population.

In the third quarter of the year, the unemployment rate was 8.5% and underemployment stood at 10.2%, according to INDEC figures. The wage index for registered workers in the private and public sectors rose at annualized rates of 33.5% and 29.7%, respectively, in the first half of the year, which meant real reductions of 3.6% and 6.3%. In September, the minimum wage was raised to 7,560 pesos and the minimum pension to 5,661 pesos (corresponding to nominal increases of 35.3% and 31.7%).