Argentina

Economic activity in Argentina expanded during 2017, with a rise of 2.5% in the first nine months of the year driven by growth in private consumption, public spending and investment, and more than making up for the drop of 2.2% in 2016. At the same time, the inflation rate fell from 40.5% in 2016 to 26% in the first 10 months of 2017, and employment was up by 1.4% in the year to August.

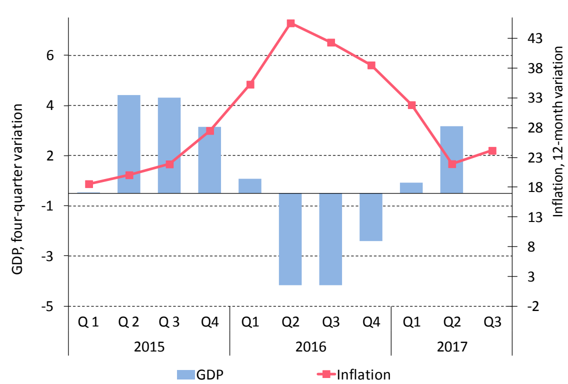
The Argentine economy's recovery during 2017 may be attributed to both external and domestic factors. Among the external factors was the slight upswing in the Brazilian economy, which was reflected in a gradual recovery in exports to that country. Among the domestic factors were the growth in wages and the increase, in real terms, in social spending, the impact of public works projects, and the rise in bank lending to the private sector, which encouraged growth in consumption and investment. With this solid performance through the third quarter of the year, it is estimated that the year as a whole will see growth of 2.9%.

Growth and employment outcomes by sector were mixed in 2017. Sectors buoyed by the change in relative prices, by public works or by specific trade agreements, such as agriculture, construction and the automotive industry, respectively, recorded high growth rates. By contrast, those affected by the relaxation of import controls and local currency appreciation, such as the textiles and electronics industries, continued their fall. Varied recoveries were also observed in the labour market, where there was a greater increase in public employment and in the numbers working in private homes or on their own account, than in private employment (which rose by only 0.4% in the course of the year to August).

The fiscal deficit and the current account deficit were financed by a marked increase in external borrowing in 2017, which also underpinned an increase in international reserves. The current account deficit widened in 2017, standing at 4.2% of GDP in the first half of the year, as a result of higher imports of goods and services (reflecting the economic recovery, the reduction in import controls and tariff rates, and the appreciation of the local currency), as well as rising interest payments on the external debt. The fiscal deficit remained high in the first 10 months of the year (at 4.7% of GDP), notwithstanding the policy of reducing subsidies for public services, the extraordinary revenues from the special tax under the capital legalization (or repatriation) programme, and the increase in tax receipts associated with greater economic activity.

In 2018, growth is expected to continue, unless there is a substantial change in international financial conditions. The pace of growth will depend, on one hand, on a sustained recovery in the country's trading partners and, on the other hand, on the trend in real family incomes and in credit to the private sector, and on the fiscal policy stance. In an expected scenario of stronger growth in Brazil in 2018, a slight increase in real wages, and real stability in public spending, the Argentine economy should grow at around 3%.

Argentina: GDP and Inflation, 2015-2017



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

On the fiscal front, policy had an expansionary thrust in 2017, based on a real increase in public spending. As a result of stronger growth in revenues as compared to expenditures during the first 10 months of 2017 (30.8% nominal versus 24.2%, respectively), the primary deficit fell to 2.8% of GDP (from 3.8% over the same period of 2016). After payment of interest on the debt, the fiscal outturn stood at 4.7% of GDP, above the 4.1% recorded in the prior-year period. On the other hand, excluding one-off revenues from capital legalization programme, the primary deficit amounted to 3.3%, and the financial deficit reached 5.2%. With respect to primary expenditure, there was notable growth in social outlays (38.2%) and in capital spending (20.4%), and a drop in economic subsidies (-22.9%). The "historic reparations" programme for retirees (which involved retroactive adjustments for pension benefits miscalculated in the past) helped to push up spending on social benefits, and the official rate hikes for gas and electricity explained the decline in economic subsidies. On the revenue side, tax receipts were up by 29.6%, reflecting the impact of economic recovery and the capital legalization programme (which yielded 43 billion pesos during the year to date, equivalent to 0.5% of GDP).

Argentina: main economic indicators, 2015-2017

	2015	2016	2017 [a]
	Annual growth rate		
Gross domestic product	2.6	-2.2	2.9
Per capita gross domestic product	1.6	-3.2	2.0
Consumer prices	27.5	38.5	22.9 [b]
Money (M1)	31.6	20.2	30.9 [c]
Terms of trade	-3.9	6.2	-0.9
	Annual average percentage		
Open urban unemployment rate [d]	6.5	8.5	9.0 [e]
Central government			
Overall balance / GDP	-3.7	-5.9	-5.5
Nominal deposit rate [f]	21.7	24.4	18.6 [b]
Nominal lending rate [g]	28.2	33.3	26.4 [b]
	Millions of dollars		
Exports of goods and services	70 032	70 596	73 056
Imports of goods and services	76 181	74 199	87 291
Current account balance	-17 170	-14 533	-26 853
Capital and financial balance [h]	12 237	28 844	39 965
Overall balance	-4 933	14 311	13 112

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 first semester.
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.

Financing of the deficit came primarily from the issuance of debt in foreign currency (US$ 52 billion between January and October) and in local currency (equivalent to US$ 20 billion). In particular, the central government's external debt rose to 19.9% of GDP in the second quarter of 2017 (from 18.1% of GDP at the end of 2016).

At the time of writing, the national government had sent to Congress a proposed tax reform designed to reduce fiscal pressure on businesses, with a view to fostering investment and exports. The most notable points seek to reduce the tax on reinvested profits (from 35% at present to 25% by 2021), and to lower employers' contributions to the social security system. As well, a plan was agreed with the provinces to adopt a new fiscal responsibility law (which includes rules governing real expenditure and employment in the provinces, as well as a review of federal tax sharing and a reduction in provincial taxes that are levied on top of national taxes). In a complementary move, the government also sent to Congress a proposed pension reform that, among other amendments, includes a new formula for updating pensions in light of inflation and wages, intended to rein in pension increases and, consequently, spending on social benefits.

On the monetary policy front, in 2017 the Central Bank of the Argentine Republic (BCRA) formally instituted an inflation targeting regime, and established a new policy interest rate (the 7-day interbank repo rate).[1] With a view to bringing inflation within the target band (between 12% and 17% for 2017), the monetary authority maintained a policy of high interest rates, which led to increased absorption of pesos through the placement of central bank bills (LEBAC) and repos. The policy interest rate followed an upward trend during the year, from 24.75% in January to 28.75% in November, in the context of inflationary pressures associated with higher charges for public services and other regulated prices. In terms of credit policy, the launch in 2016 of an instrument for indexing the principal of bank loans to inflation —known as Purchasing Value Units (UVA)— contributed to a significant growth in

[1] Repo agreements on public securities between the central bank and the commercial banks.

bank financing in 2017. There was a notable increase in mortgage loans, secured loans and personal loans, which together grew by 49% year-over-year in the period to October.

The central bank maintained the free floating exchange rate and intervened in the exchange market only at times of rapid rises. In this context, the nominal exchange rate was up by 11% during the year to October and, given inflation for that period and the trend in trading partners' currencies, the real multilateral exchange rate fell by 1.9%. Notable among the exchange and trade measures taken were the elimination of the time limit for settling foreign currencies from exports, and an increase in refunds of domestic taxes on a large portion of exported products.

In the first half of 2017, the current account on the balance of payments accumulated a deficit of US$ 12.9 billion (or 4.2% of GDP), higher than in the year-earlier period. This development was explained by a reversal of the merchandise trade balance (which turned negative) and a widening of the deficit on services and incomes. The merchandise trade deficit reached US$ 1.3 billion, due to a greater increase in imports (12.9%) than in exports (0.7%). On the import side, there was strong growth in imports of consumer goods, capital goods and vehicles. External trade data updated to October show a widening deficit (US$ 6.1 billion, equivalent to 1.4% of GDP). This is the largest trade deficit in the last 20 years. As to the deficits on the services and income accounts for the first half of the year, these rose to 1.7% and 2.2% of GDP respectively.

The current account deficit was fully offset by the surplus (6.8% of GDP) on the capital and financial account, notwithstanding the continuing sale of foreign currency to the private sector (more than US$ 17 billion in the first 10 months of the year) to build up cash balances. The main contribution came from debt issuances by the national public sector. Foreign direct investment (FDI) rose from 1.1% of GDP in the first half of 2016 to 1.7% in the first half of 2017, in the form of both capital contributions and issues of debt instruments. The increased capital and financial account surplus over the current account deficit was absorbed by international reserves, which, with the data updated to October, rose to US$ 51.8 billion (or 10% of GDP).

Economic activity recorded an increase of 2.5% year-on-year in January-September. According to information available as of the second quarter, GDP rose by 1.6% year-on-year; investment contributed 1% to growth, private consumption added 1.8%, and public consumption accounted for 0.3%. The contribution of exports and imports was negative (-0.2% and -1.8%, respectively). Subtracting the imports associated with each component of aggregate demand much reduces the contribution of private consumption and investment, to 1.4% and 0.2%, respectively. On the supply side, the increase is explained by higher output of goods (1.6%) and of services (1.7%). The following sectors made notable contributions to growth: agriculture (0.5%), transportation and communications (0.3%), real estate and business activities (0.2%), and construction (0.2%).

Inflation dropped on average from 40.5% in 2016 to 26% year-on-year between January and October 2017.[2] As of January 2017, the National Institute of Statistics and Censuses (INDEC) began to publish a consumer price index with national coverage: this recorded a cumulative increase to October of 19.3% (or 1.8% as a monthly average). On the other hand, INDEC estimated the income poverty rate at 28.6% of the population for the first half of 2017, and the extreme poverty (indigence) rate at 6.2%. The first rate was down by 1.7 percentage points from the previous half-year, and the second rate was up by 0.1 percentage points.

[2] Based on a splicing of the national consumer price index published by INDEC and available since January 2017, the consumer price index for Greater Buenos Aires, again published by INDEC and available since May 2016, and the price indices published by the Autonomous City of Buenos Aires and San Luis, weighted by population (for the months prior to May 2016).

In the second quarter of 2017, the unemployment rate stood at 8.7%, or 0.6 percentage points below the rate for the year-earlier period, in a context of an equivalent drop in the activity rate, which in the second quarter of 2017 was 45.4%, according to INDEC. The wage index for registered workers showed a nominal increase of 31% year-on-year to August, and 3.2% in real terms. Among wage earners, the real increase was greater for the private sector (4.1%) than for the public sector (1.3%). In September, the minimum wage stood at 8,860 pesos and the minimum retirement pension was 7,245 pesos. In real terms, the minimum wage rose by 1% year-on-year in the year to October, and pensions were up by 2.4%. Nevertheless, the drop recorded in 2016 has yet to be made up.