INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

CABLE ADDRESS
INTERFUND

Gentlemen:

I am enclosing herewith the text of the stand-by arrangement for Argentina approved by the Executive Board on December 28, 1984.

Sincerely yours,

Anne Marie Al-Samarrie

A. M. Al-Samarrie
Senior Operations Officer
Operations Division
for General Resources

Enclosure

Banco Central de la Republica
Argentina
Buenos Aires
Argentina

Stand-By Arrangement--Argentina

Attached hereto are a letter with an annexed memorandum dated September 25, 1984 and a supplementary letter dated December 26, 1984 from the Minister of Economy and the President of the Central Bank of the Republic of Argentina requesting a stand-by arrangement and setting forth the objectives and policies that the authorities of Argentina intend to pursue for the period of this stand-by arrangement.

To support these objectives and policies the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For the period from December 28, 1984 to March 27, 1986 Argentina will have the right to make purchases from the Fund in an amount equivalent to SDR 1,419 million, subject to paragraphs 2, 3, 4, and 5 below, without further review by the Fund.

2. (a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 236.5 million until February 20, 1985, the equivalent of SDR 473.0 million until May 20, 1985, the equivalent of SDR 709.5 million until August 20, 1985, the equivalent of SDR 946.0 million until November 20, 1985, and the equivalent of SDR 1,182.5 million until February 20, 1986.

(b) None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Argentina's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12 1/2 percent of quota.

3. Purchases under this stand-by arrangement shall be made from ordinary and borrowed resources in the ratio of 1 to 1, provided that any modification by the Fund of the proportions of ordinary and borrowed resources shall apply to amounts that may be purchased after the date of modification.

4. Argentina will not make purchases under this arrangement, other than the initial purchase equivalent to SDR 236.5 million that it may request not later than within 15 days of the effective date of this arrangement, that would increase the Fund's holdings of Argentina's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12 1/2 percent of quota:

(a) during any period in which the data at the end of the preceding calendar quarter indicate that the ceiling for the preceding quarter on the net domestic assets of the Central Bank described in paragraph 21 and Table 3 of the Memorandum of Understanding annexed to the attached letter of September 25, 1985 has been exceeded or during any period in which the ceiling for the end of the current quarter has been exceeded; or

(b) during any period in which the data at the end of the preceding calendar quarter indicate that the limit on the combined deficit of the nonfinancial public sector and the Central Bank, or the sublimit on the cash deficit of the nonfinancial public sector, or the limit on treasury outlays described in paragraph 16 and Table 2 of the Memorandum of Understanding annexed to the attached letter of September 25, 1984 has been exceeded, or during any period in which any limit for the current quarter has been exceeded; or

(c) during any period in which the data at the end of the preceding calendar quarter indicate that

(i) the understandings on regulated interest rates described in paragraph 19 of the Memorandum of Understanding annexed to the attached letter of September 25, 1984 have not been observed, or

(ii) the targets for net international reserves described in paragraph 25 and Table 4 of the Memorandum of Understanding annexed to the attached letter of September 25, 1984 have not been met, or

(iii) the schedule for the phased elimination of external payments arrears described in paragraph 26 and Table 5 of the Memorandum of Understanding annexed to the attached letter of September 25, 1984, as modified by the attached letter of December 26, 1984, has not been observed; or

(d) during any period after March 15, 1985 in which the Central Bank is not providing foreign exchange automatically at the official exchange rate and BONEX for the transfer of the proceeds from the sale of travel services as was the case prior to November 15, 1984; or

(e) during any period after March 31, 1985 in which the first review referred to in paragraph 31 of the Memorandum of Understanding annexed to the attached letter of September 25, 1984 has not been concluded or the understandings reached in that review are not being observed; or

(f) during any period after June 30, 1985 in which

(i) the individual agreements on the rescheduling of public sector debt referred to in paragraph 26 of the Memorandum of Understanding annexed to the attached letter of September 25, 1984 have not been concluded, or

(ii) the Central Bank is not providing foreign exchange automatically at the official exchange rate for the payment of interest on private sector financial debt; or

(g) during any period after September 30, 1985 in which

(i) the Central Bank is not providing foreign exchange automatically at the official exchange rate for payments and transfers related to nonfinancial services other than tourism and royalties, or

(ii) the second review referred to in paragraph 31 of the Memorandum of Understanding annexed to the attached letter of September 25, 1984 has not been concluded or the understandings reached in that review are not being observed; or

(h) during any period after November 1, 1985 in which the Central Bank is not providing foreign exchange automatically at the official exchange rate for the transfer of profits, dividends, and royalties; or

(i) during any period prior to the time that foreign exchange is provided automatically at the official exchange rate for the transfer of profits, dividends, and royalties in which the Central Bank does not permit the payment of obligations in respect of profits, dividends, and royalties through the delivery of BONEX; or

(j) during the entire period of this stand-by arrangement, while Argentina has any overdue financial obligation to the Fund, or if Argentina

(i) exceeds the limits on the total and the short term external debt of the public sector described in paragraph 27 and Table 6 of the Memorandum of Understanding annexed to the attached letter of September 25, 1984, or

(ii) imposes or intensifies restrictions on payments and transfers for current international transactions, or

(iii) introduces or modifies multiple currency practices except as referred to in paragraph 30 of the Memorandum of Understanding annexed to the attached letter of September 25, 1984, or as the result of the elimination of restrictions referred to in this arrangement, or

(iv) concludes bilateral payments agreements which are inconsistent with Article VIII, or

(v) imposes or intensifies import restrictions for balance of payments reasons.

When Argentina is prevented from purchasing under this stand-by arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Argentina and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Argentina's right to engage in the transactions covered by this stand-by arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally, or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Argentina. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Argentina and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this stand-by arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Argentina, the Fund agrees to provide them at the time of the purchase.

7. The value date of a purchase under this stand-by arrangement involving borrowed resources will be determined in accordance with Rule G-4(b) of the Fund's Rules and Regulations. Argentina will consult the Fund on the timing of purchases involving borrowed resources in accordance with Rule G-4(d).

8. Argentina shall pay a charge for this stand-by arrangement in accordance with the decisions of the Fund.

9. (a) Argentina shall repurchase the outstanding amount of its currency that results from a purchase under this stand-by arrangement, in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchases as Argentina's balance of payments and reserve position improves.

(b) Any reductions in Argentina's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

(c) The value date of a repurchase in respect of a purchase financed with borrowed resources under this stand-by arrangement will be normally either the 6th day or the 22nd day of the month, or the next business day if the selected day is not a business day, provided that the repurchase will be completed not later than seven years from the date of purchase.

10. During the period of the stand-by arangement Argentina shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Argentina or of representatives of Argentina to the Fund. Argentina shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Argentina in achieving the objectives and policies set forth in the attached letters and annexed memorandum.

11. In accordance with paragraph 4 of the attached letter of September 25, 1984, Argentina will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria in paragraph 4 above have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of the stand-by arrangement and while Argentina has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the inititative of the Government or at the request of the Managing Director, concerning Argentina's balance of payments policies.

September 25, 1984

Mr. Jacques de Larosière
Managing Director
International Monetary Fund
Washington, D.C. 20431
U. S. A.

Dear Mr. de Larosière:

1. Annexed is a Memorandum of Understanding on Economic Policy describing the economic program that the Government of Argentina intends to pursue in the coming 15 months to correct the major imbalances affecting the economy and to lay the basis for sustained economic growth.

2. In support of this program, we request herewith a stand-by arrangement for 15 months from the International Monetary Fund in an amount of SDR 1,419 million. We believe that our request for access to Fund resources in this amount is fully justified on the basis of the difficult situation facing our country and the extent of the adjustment effort that we are undertaking.

3. The Government of Argentina intends to enter into discussions with the international financial community to secure a restructuring of its debt and to obtain new external financing, and attaches great importance to any assistance the Fund could lend in this effort.

4. The Government of Argentina believes that the policies set out in the annexed Memorandum of Understanding on Economic Policy are adequate to achieve the objectives of its program but will take any further measures that may become appropriate for this purpose. The Government will consult with the Fund on the progress made in the implementation of its program and any policy adaptations that may be appropriate for the attainment of its objectives, in accordance with the Fund's policies on such consultations.

Yours sincerely,

/s/
Enrique Garcia Vazquez
President of the Central Bank
of the Republic of Argentina

/s/
Bernardo Grinspun
Minister of Economy

Annexed (1) Memorandum of Understanding on Economic Policy

December 26, 1984

Mr. Jacques de Larosière
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. de Larosière:

1. The Memorandum of Understanding on Economic Policy attached to our letter of September 25, 1984 included a schedule for the elimination of external payments arrears based on certain assumptions concerning the disbursement schedule for the balance of payments loans then being negotiated by Argentina. It was understood that the arrears schedule might need to be revised on the basis of the balance of payments financing actually arranged. It is clear by now that the timing of financing flows will be different from that assumed in late September and, therefore, there is a need to modify the schedule for the phased reduction of external payments arrears (which amounted to US$3,222 million at the end of 1983), while maintaining the objective of their elimination by the end of September 1985. Accordingly, Table 5 of the Memorandum of Understanding on Economic Policy should be replaced by the table attached to this letter.

2. On November 15, 1984, the Central Bank suspended the provision of exchange for the transfer of income derived from the sale of travel services (mainly airline tickets). Until that date, the provision of foreign exchange by the Central Bank covered 50 percent of the amount to be transferred and the remaining 50 percent was covered by BONEX delivered by the Central Bank. This system gave rise to certain problems, as tickets were priced in pesos at the official exchange rate of the day the tickets were sold while the peso proceeds were transferred up to two weeks later (the time needed to complete clearing arrangements between travel agents and airline companies). Under the present system, U.S. dollar ticket prices are converted into pesos on the basis of a coefficient that reflects the peso price of BONEX in Argentina and the U.S. dollar price of BONEX abroad and it is possible to transfer ticket receipts through the BONEX market. This system for transferring ticket proceeds is to be maintained only while alternative measures that do not give rise to an exchange restriction are being designed. The Government in any case will return by not later than March 15, 1985 to a system whereby at least 50 percent of the proceeds from the sale of travel services will be made available in foreign exchange and the remainder in BONEX, and will fully eliminate the restriction by not later than September 30, 1985.

Yours sincerely,

/s/
Enrique Garcia Vazquez
President of the Central Bank
of the Republic of Argentina

/s/
Bernardo Grinspun
Minister of Economy

Memorandum of Understanding on Economic Policy

1. The Constitutional Government that assumed office on December 10, 1983 was faced with an extremely difficult economic situation, which was the result of years of economic mismanagement characterized by frequent turns in the orientation of policies. This inherited situation can be summed up as follows: (a) an external debt (including US$3.2 billion of external payments arrears) five times larger than the annual value of merchandise exports; (b) a monthly inflation rate that had fluctuated between 15 and 20 percent for several months; (c) a level of real GDP in 1983 similar to that of 1975 and 15 percent lower on a per capita basis; (d) a cash deficit of the nonfinancial public sector equivalent to about 14 percent of GDP in the second half of 1983; (e) a sharp decline in private investment, a deterioration in the fixed capital stock and a depletion of business inventories (including livestock) over the previous several years; and (f) an external trade and payments system that was encumbered by severe restrictions. One bright spot in this somber picture was an expanded capacity for agricultural production, based on technological improvements over the past two decades.

2. The Government is convinced that restoration of satisfactory economic performance and sustained growth will not be possible unless inflation is brought under control and external imbalances are corrected. A lasting economic expansion requires a revival of private investment, in order to rebuild the country's productive apparatus after the deterioration that occurred in the last decade. In turn, a revival of investment requires a marked reduction of the uncertainty generated by high and rising inflation. Moreover, the problems stemming from supply rigidities due to deficiencies in infrastructure and to inefficiencies in the production and distribution of goods and services must be addressed. Since taking office, the Government has followed an economic strategy geared to overcoming the country's difficult situation, based on efforts on two fronts: (a) an incomes policy that has sought a progressive reduction in the growth rates of key prices in the economy, while limiting as much as possible fluctuations in relative prices; and (b) a reduction in the public sector deficit and in the rate of monetary expansion.

3. In the past nine months, there have been improvements in certain aspects of the economic situation. The moderate economic recovery that had started around mid-1982 but stopped in the latter part of 1983 has resumed. At the same time, the current account of the balance of payments improved in the first half of 1984, and measures have been taken to facilitate the flow of imports and import financing by eliminating private external trade arrears. Also, there has been a reduction in the cash deficit of the nonfinancial public sector to about 8 1/4 percent of GDP in the first half of 1984. Monetary expansion has continued to be rapid, however, and inflation has not come down, as the struggle

of various groups for higher income shares has not abated. The 12-month rate of increase in the consumer price index was 615 percent in July 1984, up from 434 percent in December 1983. The annual rate of inflation was even higher in August.

4. In recent weeks, the Government has been reassessing its economic policies in light of the experience of the past several months and has decided to strengthen the anti-inflation policies. The authorities have designed a plan aimed at reducing inflation progressively to no more than 300 percent in the year ending in September 1985 and to an annual rate of approximately 150 percent during the last quarter of that year. To this effect, the Government has decided to tighten its fiscal and monetary policies, and to replace the monthly setting of key variables by an approach based on a longer time horizon. The Government is convinced of the importance of trying to avoid recessionary conditions if the economic program is to succeed and, in preparing its financial program, it has provided for moderate growth of output next year. Incomes and demand policies will be carefully harmonized to minimize the short-term effects of a slowing of the rate of increase of nominal demand on the level of economic activity and employment.

5. The Government is aware that attainment of the inflation objective referred to in the previous paragraph will require a major slowing in the pace of increase in costs, including nominal wages. In this respect, the Government has been re-examining the various arrangements (including indexation schemes) that have been used in the setting of wages since last December. Given the prevailing high rate of inflation, for the time being the Government will continue to decree monthly wage adjustments for the public and private sector, with catch-up increases from time to time to provide a measure of protection for real wages. The size of the monthly and catch-up increases and the length of the period between catch-up adjustments will be determined with a view to ensuring that they are consistent with the Government's price objectives. It is the intention of the Government to adopt, as soon as circumstances permit, a policy under which wage determination in the private sector would be left to direct negotiation between management and labor.

6. The intensification of the inflationary process in August 1984, when consumer prices rose by 22.8 percent, led the Government to adopt emergency measures. The fiscal and monetary program for September was designed to be compatible with a rate of inflation of 16 percent, which represents a significant effort to break the inflationary spiral. Moreover, there was a generalization of the system of price controls, as an extraordinary and short-term measure. The system that has been adopted allows increases of up to 16 percent in controlled prices in September, in line with the norm applied to wages, public sector prices, and fuel prices. It is the intention of the Government to apply the price controls flexibly in order to avoid adverse consequences for private investment and economic growth and with a view to preventing the emergence of shortages. Controls will be progressively phased out

as inflationary expectations become less volatile and competitive conditions in the economy are improved with the liberalization of the import system. It is expected that the emergency measures introduced in September will be eliminated before the end of the year.

7. The Government believes that the intensification of inflationary pressures and the decline in private investment in recent years have been the result--inter alia--of the sizable public sector deficits registered since 1980 and the rise in government expenditure that has occurred over the past decade. The fiscal situation worsened markedly in the period leading to the October 1983 elections and the transfer of power to the Constitutional Government in December 1983. During that period, spending rose sharply owing in part to large wage increases while adjustments in public sector prices lagged and there was growing tax evasion. Thus, the fiscal situation inherited by the elected Government was extremely difficult; the cash deficit of the nonfinancial public sector amounted to 11.4 percent of GDP in 1983 and 16.5 percent of GDP in the fourth quarter of the year.

8. The Government is convinced that, if inflation is to be curbed, the deficit of the public sector will have to be brought down markedly. Accordingly, the Government has designed a fiscal plan that would reduce the cash deficit of the nonfinancial public sector to 8.1 percent of GDP in 1984. Furthermore, it is the intention of the Government to bring the deficit down to 5.4 percent of GDP in 1985. Quarterly projections of the cash deficit of the nonfinancial public sector in relation to GDP are presented in Table 1.

9. Containment of public sector expenditure is a major objective of government policy. In the first half of 1984, while the budget that was submitted to the National Congress in June was being prepared, the Government acted to put a cap on budgetary allocations. Central administration spending (except for wages, transfers, and interest payments) was limited to a proportion of the 1983 budget that implied a low level of expenditure in real terms. In addition, there was a freeze on the filling of vacancies, and treasury transfers to the public enterprises and to the provinces were curtailed. In the first half of 1984, treasury transfers (except for the payment of interest and guarantees) to provinces, public enterprises, special accounts, and decentralized agencies were reduced by 28 percent in real terms, relative to the level in the second half of 1983. At the same time, the outlays of the Central Administration for goods and nonpersonal services and for investment fell by more than 30 percent in real terms.

10. The expenditure policy contained in the budget proposal now being considered by the Congress allows for a reallocation of resources, with military expenses being cut back while outlays for social services, health, housing, and education are expanded. Treasury transfers to the other segments of the National Administration and to the provinces are to be strictly limited. It is expected that the provinces will rely

increasingly on their own sources of revenue to meet their requirements; accordingly, treasury transfers to the provinces would be substantially reduced in 1984 and 1985 in relation to the level of 2.9 percent of GDP observed in 1983. Likewise, it is projected that the social security system will reduce its financing needs in 1984 below its 1983 level, in terms of GDP, and that it will be in equilibrium in 1985.

11. Notwithstanding the efforts to control expenditure, it is probable that there will be a pickup in the ratio of expenditure to GDP following approval of the budget by the National Congress. However, cash expenditure of the nonfinancial public sector (excluding the current expenditure of the public enterprises and including their current account deficit) will not exceed 32.9 percent of GDP in 1984, compared with 33.9 percent in 1983 and 36.5 percent in the second half of that year. In preparing the budget proposal for 1985, the Government will aim at rolling back further the relative weight of government expenditure in the economy, with the intention of containing the ratio of general government spending to GDP to no more than 32 percent in the first half of the year and of bringing it down to no more than 31 percent in the second half. As part of that effort, the Government will identify areas in which it would be appropriate to reduce the size of government, including through the divestment of publicly owned companies.

12. The improvement in the fiscal position that is being projected for 1984 results from tax measures that are expected to have a total revenue-raising effect equivalent to some 4 percentage points of GDP by the end of the year. A 5 percent employer tax on wages (earmarked for housing) was enacted in April and a 7.5 percent employers' contribution to social security in August. In addition, revenues have been boosted by an increase of about 80 percent in real terms in the tax on gasoline from December 1983 to August 1984. The Government also is giving high priority to a tightening of tax administration procedures to curb tax evasion.

13. A partial offset to the measures just mentioned has been a reduction in real terms of about 6 percent since the beginning of 1984 in the prices charged by public enterprises, which has weakened the operating position of many enterprises. The Government will implement a policy aimed at achieving a recovery in the real level of public sector prices at the same time that the operating efficiency of the enterprises is improved, avoiding that the recovery in rates be translated into higher current spending. In any event, the prices charged by the enterprises will not be allowed to decline in real terms. Moreover, treasury transfers to the enterprises will be strictly limited, and the fiscal program provides for a reduction of about 20 percent in the ratio of such transfers (including current and capital transfers, and payment of interest and of guarantees) to GDP from 1983 to 1984; this ratio will not rise in 1985. The budget proposal for 1984 contains a clause that for the first time requires the enterprises to submit their annual budgets to the Executive Branch for approval, which is expected to constitute an important instrument of control over the expenditure of the enterprises.

14. In addition to the weakening of the finances of the nonfinancial public sector, in 1983 a substantial imbalance of a fiscal nature emerged in the Central Bank. The Central Bank assumed the financing, at very low interest rates, of public sector operations previously covered by the financial sector and the nonfinancial private sector. Moreover, the interest rate paid by the Central Bank on part of its deposits was higher than the average interest rate that the Bank received on its rediscounts. The operating deficit of the Central Bank, including the interest cost on the Bank's net international liabilities, averaged about 1 percent of GDP in 1983 and rose to 3.5 percent of GDP in December of that year. The Central Bank has taken certain steps to strengthen its operating results, and its losses have started to decline and are projected to be completely eliminated by early 1985. The interest spread at which the Bank operates in the regulated financial market has been widened from 1 to 1.5 percentage points and the Bank has raised its income by applying indexed rates to an increasing proportion of its rediscounts. Furthermore, the reduction in the financing requirements of the nonfinancial public sector has worked to lower the Bank's operating losses.

15. The cash deficit of the nonfinancial public sector plus the operating position of the Central Bank is projected to decline from about 12.5 percent of GDP in 1983 (and nearly 18 percent in the fourth quarter of the year) to 10.2 percent in 1984 and 5 percent in 1985. Such a decline would facilitate a tightening of monetary policy without unduly squeezing the private sector, and would make room for a needed improvement in the current account of the balance of payments. Quarterly projections of the global deficit referred to in this paragraph, as well as those of the operating results of the Central Bank, are presented in Table 1.

16. Consistent with the objectives of reducing the deficit of the public sector and curbing public spending, the Government has set limits in current pesos, presented in Table 2, for the combined deficit of the nonfinancial public sector and the Central Bank; a sublimit on the cash deficit of the nonfinancial public sector; and a limit on treasury outlays (excluding interest payments). In setting the limits on treasury outlays, it has been assumed that there will be no significant changes in the present arrangements regarding the financing of the rest of the public sector. If such arrangements were modified, the effect of the changes would be taken into account in estimating treasury outlays. Changes in outstanding treasury drafts (libramientos impagos) are included in the definition of treasury outlays.

17. The large increase in the fiscal deficit and the difficulties encountered by financial intermediaries starting in 1980 gave rise to a loss of monetary control, with the monetary aggregates expanding at ever higher rates. To achieve the Government's inflation and balance of payments objectives, there must be a sustained reduction in the rate of growth of credit and money. It is expected that to the extent that

stabilization policies take hold and expectations about inflation abate, real money balances will increase; indeed, such an increase would be an indication of the success of policies. However, in the early stages of the anti-inflation program, monetary policy will be based on a cautious projection of the growth in the monetary aggregates. As part of this policy, the rate of expansion of M-4 for the month of September was targeted at 14 percent, compared with rates of adjustment in other key policy variables of 16 percent. The Central Bank's credit program will continue to be based on a reduction in the rate of increase of the monetary aggregates, in accordance with the Government's objectives regarding inflation.

18. In 1982-83 the Central Bank introduced major changes in the working of the financial system, which came to operate with high reserve requirements and long-term central bank rediscounts. This situation gave rise to an imbalance between the average maturities of private sector deposits and loans, which created a great deal of inflexibility in the management of the traditional instruments of monetary control. Since December 1983, the Central Bank has taken measures to improve the efficiency of financial intermediation. To this effect, the recovery of principal and interest on rediscounts was accelerated, and these resources were returned to the private sector through reductions in reserve requirements, giving priority to the interior of the country; the scope of these changes was constrained by the existence of prior commitments to refinance loans to the private sector. Moreover, the Central Bank gave priority to the expansion of medium-term credit at indexed rates and of short-term credit through bankers' acceptances; the Central Bank intends to continue with this policy. The Government is undertaking a reform of the financial system, as a result of which the lending capacity of financial intermediaries will come to depend mainly on their deposits; thus, these institutions will assume the risks resulting from the difference between deposit and loan maturities.

19. It is important that interest rates in Argentina be managed flexibly, so that financial saving be encouraged and credit be allocated efficiently. Even though the share of financial transactions at regulated interest rates has been declining, regulated deposits still represent more than one half of all interest-bearing deposits. Regulated deposits are the only liquid instrument that is not subject to limits on the amounts that can be received by financial intermediaries and the only liquid instrument available to small savers. The objective of the Central Bank as regards the regulated financial market is to ensure that the interest rate on deposits be approximately zero in real terms and that the interest rate on loans be moderately positive. Thus far this year, regulated interest rates have been fixed monthly on the basis of projected inflation and, in fact, they have been lower than the rate of inflation by wide margins, as inflation turned out to be higher than projected. The Central Bank will determine regulated interest rates in accordance with the evolution of prices, using as a reference point the interest rate on bankers' acceptances, which will continue to be

determined freely in the market. The Central Bank will adopt the measures needed to ensure that, starting in the fourth quarter of 1984, the quarterly averages of the regulated interest rate on deposits do not fall short of the quarterly averages of monthly rates of increase of a combined index of prices by more than 1/2 percentage point a month, and that regulated interest rates on loans be maintained above rates on deposits.

20. An important objective of credit policy is to provide for an increase of financing to the private sector to make possible an increase in economic activity, while avoiding the validation of rates of inflation higher than those established in the economic program. For September 1984, the rate of increase of credit to the private sector has been set at 14 percent; this result would come from a contraction in nominal terms in credit at regulated interest rates (as a consequence of an average increase in reserve requirements of 4 percentage points) and a rise in credit through bankers' acceptances and indexed loans.

21. In line with the Central Bank's monetary program, quarterly targets have been established for the net domestic assets of the Central Bank (defined as currency issue minus the net international reserves of the Central Bank), as shown in Table 3. For subsequent quarters, the Central Bank's credit policy will be based on a projection of monetary liabilities consistent with the Government's inflation and balance of payments objectives and taking into account the behavior of money balances in the coming months.

22. Argentina has already achieved a major adjustment in its external accounts, as is evidenced by the shift in the balance on goods and nonfactor services from a deficit of US$3 billion in 1980 to a surplus of US$3 billion in 1983. Over that period, however, interest on the external debt rose from about US$2 billion to almost US$5.5 billion, and the current account has remained in deficit. Upon taking office in December 1983, the Government was faced with an external debt of US$45.5 billion, an amount equivalent to two thirds of GDP. The interest alone on that debt represents about 8 percent of GDP and is equivalent to more than one half of receipts from exports of goods and services.

23. The Government is committed to servicing the external debt, while limiting new borrowing so as not to compound the problem for the future. At the same time, the Government intends to set the economy on a path of sustainable growth, and considers that these objectives can be reconciled only through a strong expansion of exports. As part of the export-oriented strategy, the import duty on fertilizers has been lowered, a significant step toward reducing the cost/price distortions that restrain the expansion of agriculture in Argentina. Moreover, the Government is encouraging the formation of trading companies so as to promote the growth of industrial exports. Such efforts can, however, be successful only if foreign markets are open to Argentine products.

24. A strong increase in exports will require domestic prices sufficiently remunerative to encourage an expansion of production. Exchange rate policy must, therefore, play a central role. From the outset, the Government has sought to maintain Argentina's competitiveness by adjusting the exchange rate in line with projected inflation for each month; however, actual inflation has in fact exceeded the monthly projections and during the first eight months of 1984 the peso has appreciated in real terms. In order to reverse this trend, the Government has started to adjust the exchange rate by more than the increase in prices. The Government intends to adjust the exchange rate as necessary to attain the balance of payments objectives of the program. At a minimum, the exchange rate will be adjusted in line with the evolution of domestic prices vis-a-vis international prices.

25. The Government believes these policies will permit an increase in the surplus on account of goods and nonfactor services from US$3 billion in 1983 to US$3.7 billion in 1984 and to US$4.3 billion in 1985. However, the impact of recent rises in international interest rates will offset a substantial part of this improvement. The authorities are projecting a reduction of the current account deficit from US$2.4 billion in 1983 to US$2.2 billion in 1984 and 1985. Credit policy should ensure that incentives to capital outflows do not arise, and it is expected that by 1985 there will be a recovery of direct foreign investment and some resumption of private capital inflows. In all, the Government has targeted a reduction in the overall balance of payments deficit from US$2.5 billion in 1983 to US$2.3 billion in 1984 and to US$1.8 billion in 1985. Quarterly targets for net international reserves are set forth in Table 4.

26. To finance these deficits and to provide for both the elimination of external payments arrears and a needed increase in the gross reserves of the Central Bank, exceptional financing from official and private creditors will be required. The Government has stated informally that it intends to negotiate with the Paris Club the rescheduling of service payments on medium- and long-term debt that were in arrears at the end of 1983 and that come due in 1984 and 1985. The Government also will seek to reach, as soon as possible, agreement in principle with creditor banks on the rescheduling of public sector debt that has matured since April 1982 or will mature through December 1985, and to conclude all the individual agreements by June 30, 1985. External payments arrears are to be eliminated by the end of September 1985 and no new arrears will be incurred after that date; a schedule for the phased elimination of external payments arrears is included in Table 5.

27. A substantial portion of the exceptional financing that is required will be used to repay arrears and other obligations, often to the same creditors that are providing such financing. The total external debt, including obligations to the Fund, would increase by about US$4.5 billion, or about 10 percent, over the two years 1984 and 1985. Consistent with this overall growth in debt, limits have been established for the

total, and the short-term, external debt of the public sector; these limits are presented in Table 6.

28. In order to foster efficient resource allocation and economic growth and to restore private sector confidence, the Government intends to simplify the exchange and trade system and eliminate restrictions to the extent permitted by the availability of foreign exchange. With a view to allocating scarce exchange at a time of large payments arrears, in September 1983 external payments and transfers were made subject to prior central bank approval. It is the intention of the Government, pari passu with the reduction of external payments arrears, to make foreign exchange available for bona fide payments and transfers for current international transactions; with respect to the private sector this will be done on an automatic basis. In pursuing this objective, priority has been attached to private sector import payments; by August of this year all private sector import payments, other than those expected to be rescheduled, were on a current basis and foreign exchange is now being, and will continue to be, made available automatically for such payments. On the basis of the expected improvement of the balance of payments and the external financing to be obtained, the Central Bank intends to provide, as soon as possible, foreign exchange for interest payments and for transfers related to nonfinancial services, profits, dividends, and royalties. In the meantime, the cancellation of obligations in respect of profits, dividends, and royalties will continue to be permitted through the delivery of BONEX. Moreover, the regulations regarding the restructuring of loans with exchange rate guarantee which mature in 1984 will be announced before December 31, 1984.

29. Shortly after taking office, the Government abolished the foreign exchange allocation system for imports that had been introduced in October 1983 and established a regime under which imports were divided into three categories: prohibited, with licenses granted upon approval by the Commerce Secretariat, or with licenses granted automatically. Import items presently included in the automatic authorization regime represented 63 percent of the total value of imports in the period from July 1, 1981 to June 30, 1982; the Government intends to raise the proportion of imports under automatic authorization. The measures taken in this area and the Government's objectives will be considered on the occasion of the review of the program that is to take place in the first quarter of 1985.

30. Henceforth and during the period of the stand-by arrangement from the Fund, the Government will not impose any new or intensify any existing restrictions on payments and transfers for current international transactions, conclude any bilateral payments agreement inconsistent with Article VIII of the Articles of Agreement, or impose any new or intensify any existing import restrictions for balance of payments reasons. Moreover, henceforth and during the period of the stand-by arrangement, the Government will not introduce or modify any multiple currency practice, except for the reclassification of exports eligible for export rebates

within the existing range of rates, provided such reclassification does not increase the weighted average export rebate.

31. In the first quarter of 1985, and again around mid-year, the authorities will review with the Fund the progress in implementing their economic program in order to reach comprehensive understandings, if necessary, on additional measures to ensure achievement of the program's objectives. During the first review, stock will be taken of the external financing secured in support of the Government's program, and the objectives with regard to the balance of payments, external arrears, external debt, and the exchange system will be re-examined with a view to ensuring consistency between those objectives and the timing and amounts of external financing. Import policy as described in paragraph 29 also will be considered. In the second review, it also will be considered whether, in the light of balance of payments developments, more rapid progress might be made toward the Government's objective of placing external payments on a current basis and eliminating exchange restrictions and multiple currency practices. At the time of the first review, limits will be set for an additional six-month period for the variables in current pesos referred to in paragraphs 16 and 21. During the second review, limits in current pesos will be set for these variables for the remainder of the program period.

Table 1. Argentina: Quarterly Projections of the Cash Deficit of the Nonfinancial Public Sector, the Operating Result of the Central Bank, and the Combined Deficit of the Nonfinancial Public Sector and the Central Bank

(In percent of GDP)

	Cash Deficit of the Non-financial Public Sector (-)	Operating Result of the Central Bank	Combined Deficit of the Non-financial Public Sector and the Central Bank (-)
July-September 1984	-7.2	-2.4	-9.6
October-December 1984	-8.7	-1.3	-10.0
January-March 1985	-5.9	--	-5.9
April-June 1985	-7.1	-0.4	-7.5
July-September 1985	-3.8	0.5	-3.3
October-December 1985	-5.3	0.9	-4.4

Table 2. Argentina: Limits on the Cash Deficit of the Nonfinancial Public Sector, the Combined Deficit of the Nonfinancial Public Sector and the Central Bank, and Treasury Outlays

(In billions of pesos argentinos)

Period	Cash Deficit of the Nonfinancial Public Sector	Combined Deficit of the Nonfinancial Public Sector and the Central Bank	Treasury Outlays
July-December 1984	282.1	342.3	343.5
July 1984-March 1985	476.3	536.5	621.6

Table 3. Argentina: Targets for Net Domestic Assets of the Central Bank 1/

(In billions of pesos argentinos, end of period)

June 1984	507.2
December 1984	884.5
March 1985	1,006.2

1/ The net domestic assets of the Central Bank are defined as currency issue at the end of the month minus the net international reserves of the Monetary Authorities at the end of the month (valued at the rate of exchange of $a 51.242 per U.S. dollar). The level for the end of June 1984 is included for purposes of defining the series.

Table 4. Argentina: Targets for Net International Reserves of the Monetary Authorities

(In millions of U.S. dollars, end of period)

December 1983	-6,383
June 1984	-6,769
December 1984	-8,850
March 1985	-9,570
June 1985	-9,450
September 1985	-9,650
December 1985	-10,650

1/ For measuring balance of payments performance, international reserve assets and liabilities in currencies other than the U.S. dollar will be converted to U.S. dollars at the market exchange rates of June 30, 1984 and gold will be valued at US$325 per fine troy ounce. The net international reserve targets will be adjusted for any other changes in the value of reserve assets and liabilities that result from factors other than balance of payments flows. The data for December 1983 and June 1984 are presented for purposes of defining the series.

Table 5. Argentina: Revised Limits on Outstanding External Payment Arrears 1/

(In millions of U.S. dollars, end of period)

December 1983	3,222
June 1984	3,778
December 1984	4,470
March 1985	2,760
June 1985	1,250
September 1985	--
December 1985	--

1/ For purposes of these limits, external payments arrears are defined to exclude: (a) principal amounts subject to rescheduling under general principles agreed between Argentina and its foreign bank creditors; (b) principal on loans originally covered by swap contracts with the Central Bank; (c) deposits placed with the Central Bank in conformity with Circular A 404; and (d) principal on loans for which the domestic private sector borrower obtained an exchange rate guarantee from the Central Bank in 1981 or 1982. The data for December 1983 and June 1984 are included for purposes of defining the series.

Table 6. Argentina: Limits to the External Debt of the Public Sector During the Program Period

(In millions of U.S. dollars)

Limit to the total outstanding disbursed external debt of the public sector 1/	39,700
Limit to cumulative net disbursements of short-term debt of the public sector contracted after September 30, 1984 2/	2,500

1/ The definition of total outstanding disbursed external debt of the public sector includes all external obligations of the public sector, including the Central Bank of the Republic of Argentina (BCRA) and the official banks. However, this definition excludes bonds and notes issued in lieu of providing foreign exchange to meet principal payments falling due on private sector debt covered by exchange rate guarantees, obligations deriving from the assumption by the public sector of debt of private domestic borrowers after December 31, 1983, and those categories of obligations not subject to the Central Bank's debt registration system as of September 15, 1984. It includes loans covered by swap arrangements undertaken by the Central Bank.

2/ Includes cumulated disbursements, net of repayments, of debt with a maturity up to one year, contracted by public sector entities after September 30, 1984, other than obligations classified as reserve liabilities.