Direct Investments in Resident Enterprises

December 31, 2016

BANCO CENTRAL
DE LA REPÚBLICA ARGENTINA

Direct Investments in Resident Enterprises as of December 31, 2016

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Executive Summary

- After a strong recovery in 2015, world flows of foreign direct investment lost momentum in 2016 and went down 2% year-on-year (y.o.y) at a global level within a context of weak economic growth worldwide, with Latin American economies having been the most affected with a drop of around 10% as a whole.

- In the domestic context, as from December 2015, a series of measures were adopted with a view to encouraging investments into the country. To this effect, together with the regularization of the access to the foreign exchange markets, regulations became more flexible in order to provide more freedom to capital movement with foreign countries.

- Within this framework, Argentine direct investment enterprises cancelled liabilities with their investors, in terms of both debt instruments and retained earnings, which had accumulated in the period characterized by stringent foreign exchange restrictions from 2011 to 2015. As a result, they started a process to resume their previous indebtedness levels.

- The drop in the estimated income in US dollars of direct investment enterprises added to the decline in the reinvestment rate to a level similar to the levels observed before 2011 resulted in reinvestment flows for US$ 1.83 billion in 2016.

- Likewise, as a result of the regularization in the access to the foreign exchange market, there were net debt settlements with affiliated enterprises for US$ 4.77 billion, reaching a historical maximum value in the surveyed series, with net payments of commercial liabilities for US$ 4.06 billion and of financial liabilities for US$ 705 million.

- Net capital contributions resulted in inflows for US$ 3.28 billion; in turn, net inflows from transfers of equity amounted to US$ 56 million.

- As a result, net inflows from foreign direct investment (FDI) totaled US$ 395 million in 2016.

- Thus, as of December 31, 2016, the FDI estimated gross liability position in Argentine enterprises stood at approximately US$ 74.92 billion, accounting for 14 percentage points (p.p.) of GDP. Out of this total, 71% corresponded to equity in the enterprises' net worth value (US$ 53.33 billion) and 29% (US$ 21.59 billion) to direct investment debt liabilities.

<u>Methodological explanatory note about the valuation criterion</u>: Positions were estimated using enterprises' financial statements which include, in part, updates in the values of their assets and liabilities according to international accounting standards. No adjustment was made to the valuations of the property, plant and equipment and their associated depreciation. For the conversion of values originally reported in pesos into their equivalent value in US dollars, the Reference Exchange Rate of the Central Bank of Argentina (Communication "A" 3500) corresponding to the last business day of the period in the case of positions and to the average for the period in the case of flows was used.

[1] Report prepared according to criteria stated in the IMF's Balance of Payments and International Investment Position Manual, Sixth Edition (BPM6). Paragraph 6.11 states the following: "A **direct investor** is an entity or group of related entities that is able to exercise control or a significant degree of influence over another entity that is resident of a different economy. A **direct investment enterprise** is an entity subject to control or a significant degree of influence by a direct investor." For further detail on the criteria and definitions used, see ANNEX I to this Report.

Direct investments by nonresidents in Argentine enterprises as of December 31, 2016[2]

With a view to improving the quality of statistics published by the Central Bank of Argentina (BCRA), modifications were introduced in this report to the definitions and criteria adopted to estimate and present the data, in line with the international standards laid down in the Balance of Payments Manual, Sixth Edition, of the International Monetary Fund[3], and the Benchmark Definition of Foreign Direct Investment, Fourth Edition, of the Organization for Economic Cooperation and Development (OECD), all of the above within the framework of the joint work for information exchange at a granular level and of the methodologies being performed together with the National Institute of Statistics and Censuses (INDEC), including the commitment to publishing data that have been reconciled by both organizations as from the current year[4].

Among others, the changes introduced include the following[5]:

1. Changes in sectoral classifications

Changes were introduced in the classification by economic activity sector resulting in the adoption of the classification determined by CLANAE 2010 (*Clasificador Nacional de Actividades Económicas* – National Classification of Economic Activities) by INDEC[6], including breakdowns at letter and two-digit levels.

2. Review of the series related to income and foreign direct investment flows into the country

Adjustments were made to estimated direct investment inflows, based on data reported by enterprises in the "Direct Investment Survey in Argentina," prepared by the BCRA, and on the inclusion of microdata from the National Survey on Large Enterprises for 2015[7], for the purpose of seeking consistency in the statistics on the external sector disclosed by the BCRA and the statistical data published by the National Institute of Statistics and Censuses (INDEC).

Specifically, data for 2015 were re-estimated and on this basis, estimates for 2016 were calculated, taking into account the "Results by Holding," in both inventories, which are impacted by price changes, and other assets and liabilities denominated in foreign currency, which are affected by exchange rate changes.

Likewise, in line with the information provided in the statistical data about the balance of payments and with the recommendations made by international organizations, the criterion to record seizure operations was also changed, as a result of which they will be recorded now when there is an agreement between the parties involved.

3. Changes in the methodology to estimate data of deposit-taking corporations

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2 Data about direct investment by nonresidents in Argentine enterprises are estimated on the basis of the information reported by enterprises receiving investments within the framework of the Direct Investment Survey (Communication "A" 4237, as supplemented) and the information of external liabilities with their parent companies and affiliated enterprises, resulting from the Survey on Issues of Debt Securities and External Liabilities of the Private Sector (Communication "A" 3602, as supplemented).

3 These changes started with the adjustment made to statistics on private external debt by the end of 2016.

4 The estimates for 2016 presented in this report will appear in the INDEC reports on Balance of Payments and International Investment Position as from December 2017, according to the schedule announced and its figure review policy.

5 The Statistical Annex corresponding to this report includes the statistical series published in 2016, together with the new reviewed series (click here).

6 The National Classification of Economic Activities 2010 (*Clasificador Nacional de Actividades Económicas 2010* (CLANAE 2010)) became effective by Resolution No. 825, 2010, of the National Institute of Statistics and Censuses (*Instituto Nacional de Estadística y Censos* (INDEC)), by virtue of Law No. 17622, and on the basis of the International Standard Industrial Classification (ISIC) Rev. 4, of the United Nations. The CLANAE 2010 contains codes of the different economic sectors applicable to the Republic of Argentina.

Article 1 of such provision states: "The adoption of the present Classification of Economic Activities will be used within the scope of the National Statistics System (*Sistema Estadístico Nacional* (SEN)) with a view to facilitating the interrelation of official statistical data."

7 Information from the National Survey on Large Enterprises was not used to review the data corresponding to previous years of the survey by the Central Bank following the recommendation made by INDEC, based on its warning on the use of statistical series published after January 2007 and up to December 2015, since they have to be considered with reservation, except if they have been reviewed in 2016 and provided their disclosure states this condition expressly.

Within the framework of its policy aimed at optimizing the use of information regimes, the data corresponding to deposit-taking corporations were estimated using only the information available at the BCRA.

4. Changes in the methodology to estimate data of external debt with affiliated enterprises

In this report, changes were introduced to the definitions and estimation criteria, with an impact on foreign direct investment flows and positions, in line with the changes introduced to statistical data of the private sector external debt as of December 31, 2016[8]. Likewise, amounts were adjusted, taking into account the possibility of identifying the institutional sectors having a debt with affiliated enterprises that is excluded from the concept of direct investment debt.

On the other hand, the Central Bank of Argentina will launch in the next few months a new integrated questionnaire about external assets and liabilities to replace the surveys on private sector external debt and direct investment currently in force, seeking to survey the information as of the end of 2017, which will include improvements tending to make the reporting requirements easier for both enterprises and households. All of the above is part of the BCRA's adjustment policy to international standards, in terms of both data collection to estimate the different economic variables and the commitment undertaken with the G20 Group to cover information gaps as revealed by the international financial crisis starting in 2007 (G20 - Data Gaps Initiative[9]).

I) Introduction

Foreign direct investment (FDI) is an important element for international economic integration as well as a mechanism to forge direct, stable and long-term links among economies. Likewise, it is a vehicle for the development of local enterprises and it helps improve the competitiveness of both the economy receiving the investment and the economy making the investment; it fosters transfer of technology and knowledge (or know-how) between economies; it offers the recipient economy an additional opportunity for promoting its products in world markets, with a positive impact on international trade development, and it is also an important source of capital for both recipient and investor economies[10].

The distinctive characteristic of an FDI is the actual involvement of the investor in the management of the direct investment enterprise and it is made up by both the capital provided to the direct investment enterprise by the direct investor, either directly or through affiliated enterprises, and the earnings of the direct investment enterprise corresponding to the direct investor and which have not been distributed as dividends, and also by the debts between the direct investor and the direct investment enterprise.

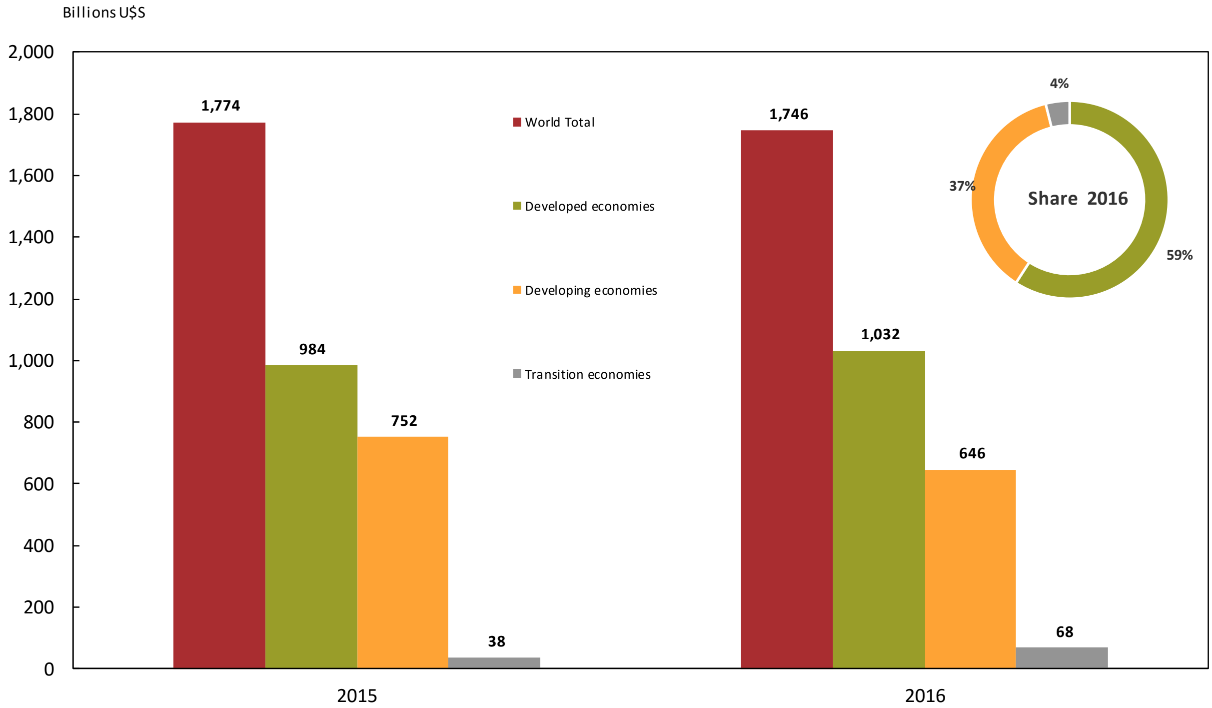
According to the United Nations Conference on Trade and Development (UNCTAD), global flows of foreign direct investments lost momentum in 2016 (see Chart I.1) after a strong recovery in 2015 as a result of an increase in cross-border mergers and acquisitions. In fact, FDI inflows went down 2% year-on-year (y.o.y.) around the world, within a context of a weak economic growth worldwide, basically due to the behavior of developed economies; as a result, developing economies were more adversely affected by the contraction of these flows.

[8] For more details about these changes, see the "Private Sector External Debt Report – December 2016" (click here)

[9] For information about the current situation, see the second progress report of the Data Gap Initiative (click here).

[10] "Foreign Direct Investment Benchmark Definition," Organization for Economic Cooperation and Development (OECD).

Chart I. 1. Foreign Direct Investment Inflows: By Group of Economies



Source: United Nations Conference on Trade and Development (UNCTAD)

At regional level and based on data from UNCTAD and the Economic Commission for Latin America and the Caribbean (ECLAC), flows into Latin American and Caribbean economies dropped over 10% y.o.y. in 2016. In GDP terms, FDI inflows to the region reached around 2.6%, standing below the average recorded in the 2010-2013 period (3.1%), after the economic recovery from the subprime crisis in the United States and Europe.

However, despite the fact that FDI inflows to Latin America and the Caribbean lost momentum in 2016, there was an increase in the FDI stock relative to the Gross Domestic Product[11], going from 34.6% in 2015 to 39.3% in 2016, according to UNCTAD.

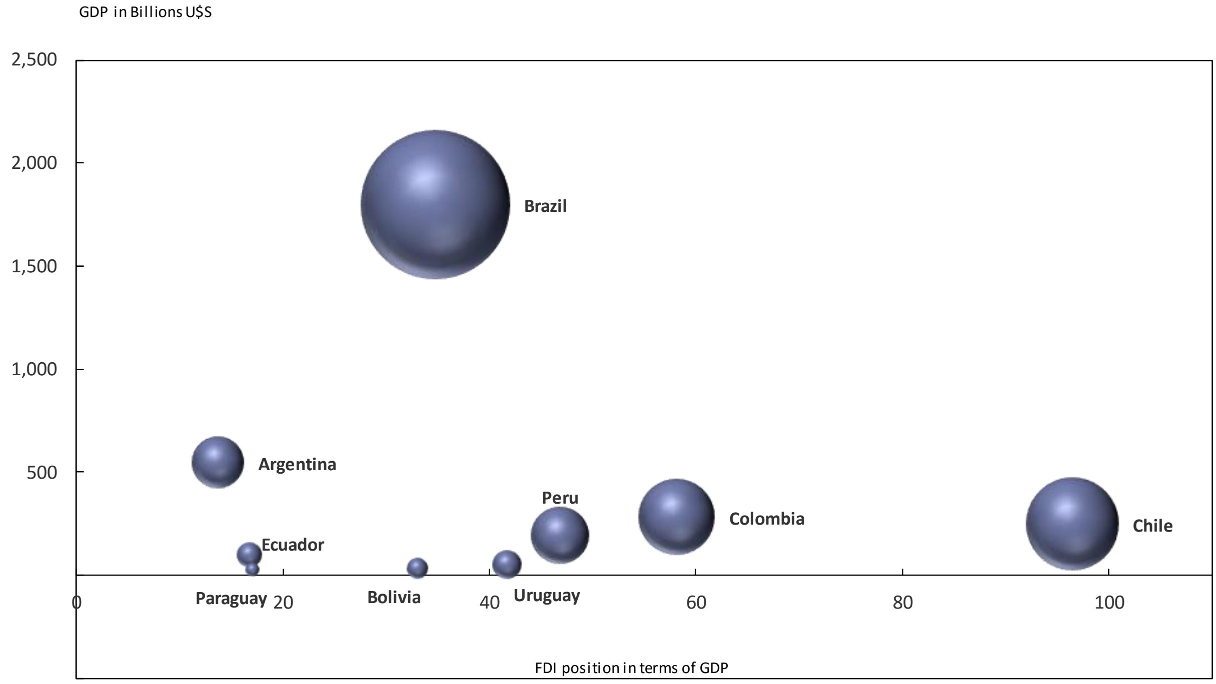
In the case of South America[12] (see Chart I.2), the FDI stock in terms of the GDP of this group of countries reached 36.3% by December 31, 2016. While Brazil (the leading economy of the region in GDP terms) recorded an FDI position of 34.8% relative to GDP, Colombia and Peru (the third and fifth largest economies of South America) reached a ratio of 58.2% and 46.9%, respectively. Lastly, in Chile, which continues to be the fourth largest country of the region in terms of economic activity, the FDI position was 96% relative to its GDP.

In the case of Argentina, the second largest economy of Latin America but with a share of only 6% in the FDI regional stock, the FDI-to-GDP ratio stood at 14%, which shows that it has opportunity for growth with reference to these flows.

[11] GDP measured in dollars at current prices (year 2016). The increase is due to a GDP drop measured in dollars in the most representative economies of the region (Argentina, Brazil, Colombia, Ecuador and Uruguay).

[12] Excluding Guyana and Suriname.

Chart I.2 Latin America. GDP and FDI Stock in terms of GDP as of December 31, 2016



Nota: The size of the sphere indicates the share of the economy in the total FDI of South America.
Source: United Nations Conference on Trade and Development (UNCTAD), Central Bank of Argentina, World Bank.

For 2017, UNCTAD had foreseen a slight recovery of FDI flows worldwide, even though the figures would still stand below the maximum values recorded some years ago[13]. In fact, the current context is considering a global economic growth rate of 3.6%[14] for 2017, evidenced in a cyclical increase in the manufacturing sector and in world trade, which would result in a faster economic expansion in developed countries. For developing nations, the strengthening of commodity prices is likely to support a recovery of these economies in 2017. As a result, FDI flows were expected to increase around 5%[15] this year.

[13] Report on world investments in 2017. United Nations Conference on Trade and Development (UNCTAD).

[14] World Economic Outlook, October 2017. International Monetary Fund (IMF).

[15] Estimate of the World Investment Report 2017. United Nations Conference on Trade and Development (UNCTAD).

II) Foreign Direct Investment Flows into Enterprises in 2016[16]

After the taking of office by the new authorities on December 10, 2015 and throughout 2016, the Central Bank of Argentina adopted a series of measures[17] tending to ensure more freedom in capital movement[18]. These standards were underpinned by additional measures in the same direction implemented by the National Government[19].

Likewise, in April 2016, the National Government put an end to the litigation conflict with bondholders, which paved the way to gain access once again to international credit markets and reduced financing cost, for both the National Government and the local governments and the private sector.

These measures impacted on the evolution of the different types of direct investment flows into the country and, above all, on the external indebtedness with affiliated enterprises and the earnings reinvested by enterprises.

In this context, during 2016, Argentine direct investment enterprises cancelled liabilities with their investors, in terms of both debt instruments and retained earnings, which had accumulated during the previous period, characterized by stringent foreign exchange restrictions in the 2011-2015 period. As a result, they started a process to resume their previous indebtedness levels.

The drop in the estimated income in US dollars of direct investment enterprises added to the decline in the reinvestment rate to a level similar to the levels observed before 2011 resulted in reinvestment flows for US$ 1.83 billion in 2016. As shown in the specific section on this topic, the percentage of reinvested profits of enterprises is expected to increase in the near future, converging to the levels observed before the implementation of the above-mentioned restrictions to access the formal foreign exchange market.

Likewise, as a result of the regularization in the access to the foreign exchange market, there were net debt settlements with affiliated enterprises for US$ 4.77 billion, reaching a historical maximum value in the surveyed series, with net payments of commercial liabilities for US$ 4.06 billion and of financial liabilities for US$ 705 million[20].

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[16] Foreign direct investment flows into local enterprises may be broken down in the following modalities:

a. Net capital contributions to a local enterprise: They evidence the decision made by the nonresident investor to broaden or withdraw the capital invested in nonresident companies. Contributions may involve fresh funds for the enterprise, a contribution in assets or rights, or debt capitalization.

b. Reinvestment of earnings: This is related to earnings generated by the investment and that have not been made available to the members.

c. Debt instruments: This includes transactional flows of direct investment debt between affiliated enterprises. As from this report onwards, a difference is established in direct investment gross liabilities changes between,

    i. Changes resulting from transactions (either by mutual consent or by virtue of a law), including earnings made available but not collected by direct investors.

    ii. Changes resulting from changes in volume, changes in classification, modifications in the exchange rates and other changes in prices.

d. Transfers of equity: This includes the purchase and sale of block of shares or other forms of equity between direct investors and other investors not falling into this category.

The distribution of earnings and dividends is recorded when they are made available to shareholders, whether they have been collected or not by the shareholder. If the earnings were not transferred to the nonresident direct investor, an increase is recorded in the debt with affiliated enterprises due to distributed, but not transferred, earnings and dividends.

The reinvestment of earnings is calculated as the difference between the income generated by the enterprise and the earnings made available to its investors, weighted according to the equity of direct investors. A negative reinvestment value implies that: a) the company recorded losses or b) the earnings made available exceed the income generated in the period.

The calculation methodology for these definitions is detailed in Annex I, at the end of this document.

[17] "2016 Objectives and Plans for the Development of Monetary, Financial, Credit and Exchange Policy." Published by the BCRA on December 31, 2015 and available in its web page.

[18] Communication "A" 5850, December 17, 2015, as supplemented, and Communication "A" 6037, August 8, 2016, as supplemented. Among other measures, the flow of current transactions and for pending payments corresponding to imports of goods and services was released; the limits on lending and borrowing rates were eliminated and the transactions in the open market were modified, while changes were introduced to the auction process of LEBACs in pesos and in dollars, and the range of instruments available was enlarged.

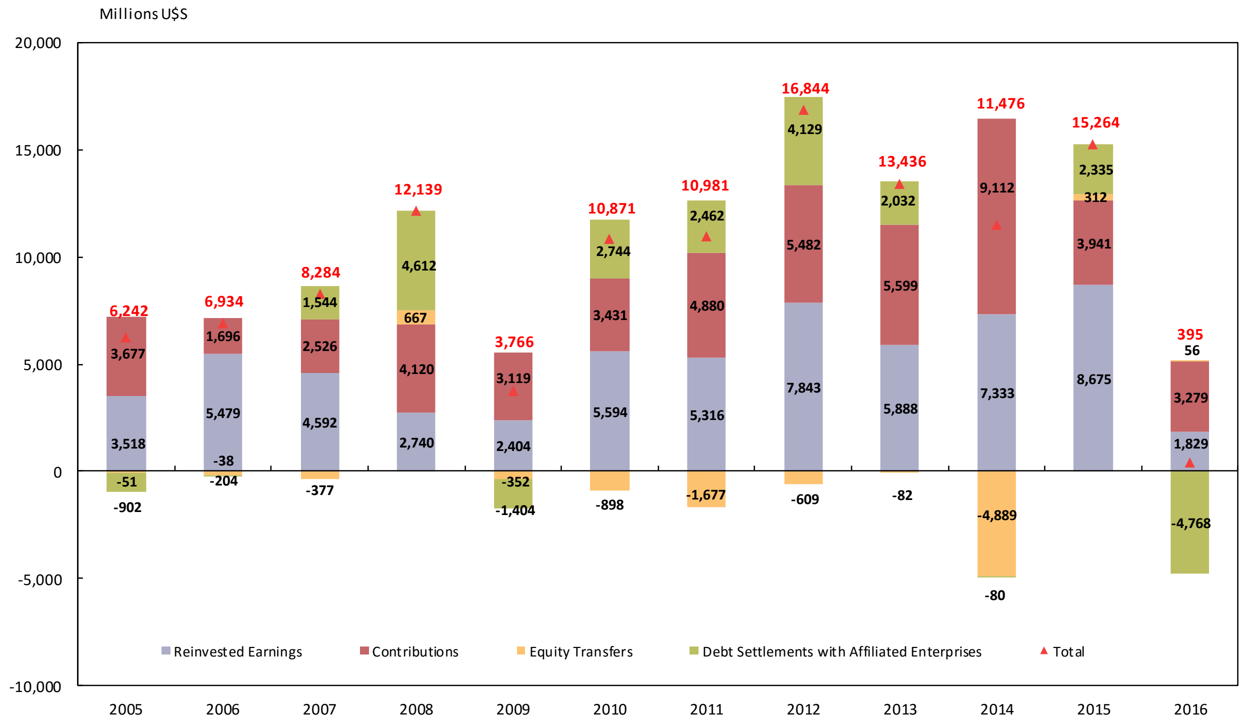
[19] These measures include, among others, the reduction or elimination of export duties on oilseeds, grains and their byproducts, and on manufacturing products; or the change in the terms for the settlement of foreign currency for collections on exports by virtue of Resolution No. 242/2016 by the Secretariat of Trade, Ministry of Production, dated August 30, 2016, which unified the term for all tariff positions at 1825 calendar days (5 years) to settle foreign currency in the domestic financial system, modified in early 2017 and taken to 3650 calendar days by virtue of Resolution No. 47/2017 by the above-mentioned Secretariat.

[20] For more information, see the "Private Sector External Debt Report – December 2016" (click here).

Net capital contributions resulted in inflows for US$ 3.28 billion and net inflows from equity transfers amounted to US$ 56 million.

As a result, net inflows from FDI totaled US$ 395 million in 2016 (see Chart II.1)[21].

Chart II. 1 FDI Flows in Argentina - Composition



II) a. Allocation of FDI flows[22]

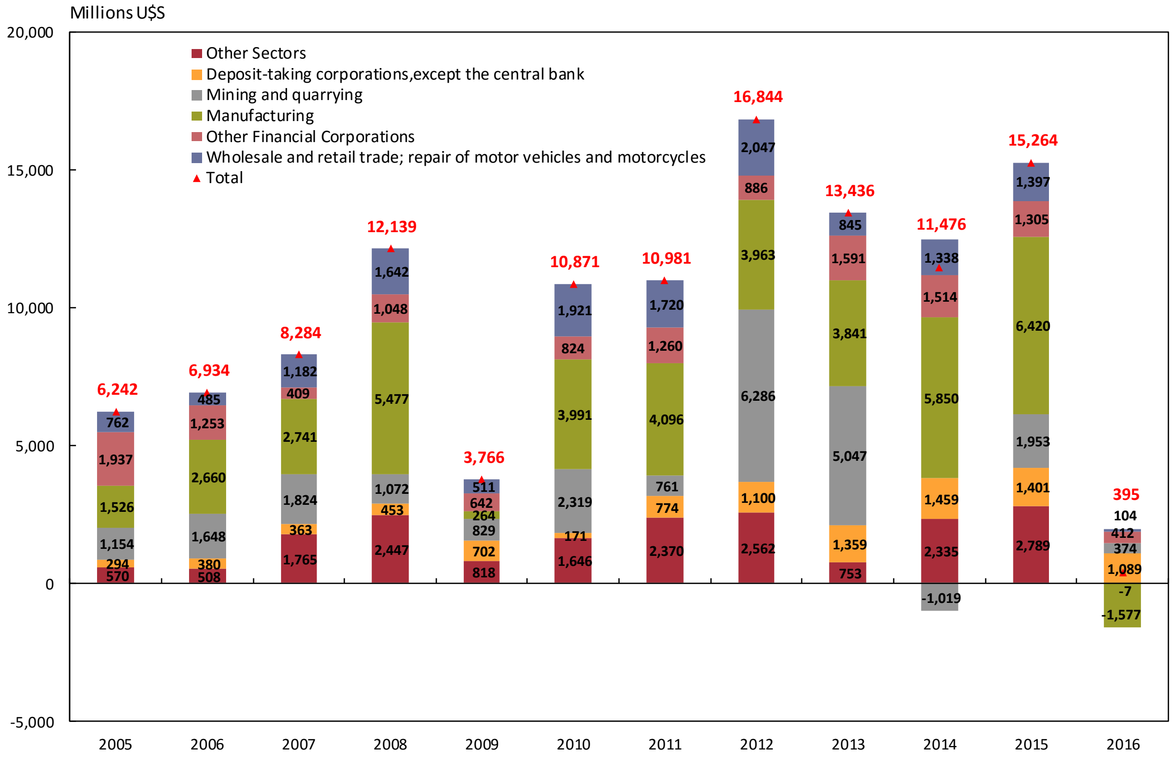
On a sector-by-sector basis (see Chart II.2), all activities suffered a drop in FDI net inflows but manufacturing was the hardest-hit segment, going from net inflows for US$ 6.42 billion in 2015 down to a net outflow for US$ 1.58 billion in 2016, mainly due to enterprises' net settlement of debt with affiliated enterprises (-US$ 2.28 billion) and to increased distribution of earnings.

The remaining sectors showed the same behavior along the year, i.e. an external debt reduction process evidenced in the net debt settlement with affiliated enterprises added to a higher level of distribution of profits. And in all cases, the result was the same: fewer foreign direct investment flows against those recorded in 2015.

[21] Data are temporary estimates subject to rectification by the reporting parties and to the incorporation of new information that might have cropped up after the closing of this publication. The effect of introducing more information tends to impact mainly on the estimates of reinvestment and contributions for the latest year of publication.

[22] The statistical annex available in section "Publications and Statistics", subsection "External Sector/Direct Investments in Resident Enterprises," of the BCRA's web page presents an in-depth breakdown, and a detail of FDI flows by activity sector and source country (click here).

Chart II.2 FDI Flows By Economic Activity Sectors



II) b. FDI income and reinvestment of earnings[23]

The income generated by FDI enterprises, measured in US dollars, totaled US$ 6.49 billion in 2016 (see Chart II.3). Out of this total, around US$ 5.98 billion corresponded to capital income and US$ 517 million to interest from the debt with affiliated enterprises.

There may be several reasons behind the drop in the income, such as the declining profits in pesos of FDI enterprises (-9%), resulting from the fall in the activity level observed in 2016[24] and the exchange rate depreciation, which impacted adversely on the income measured in dollars.

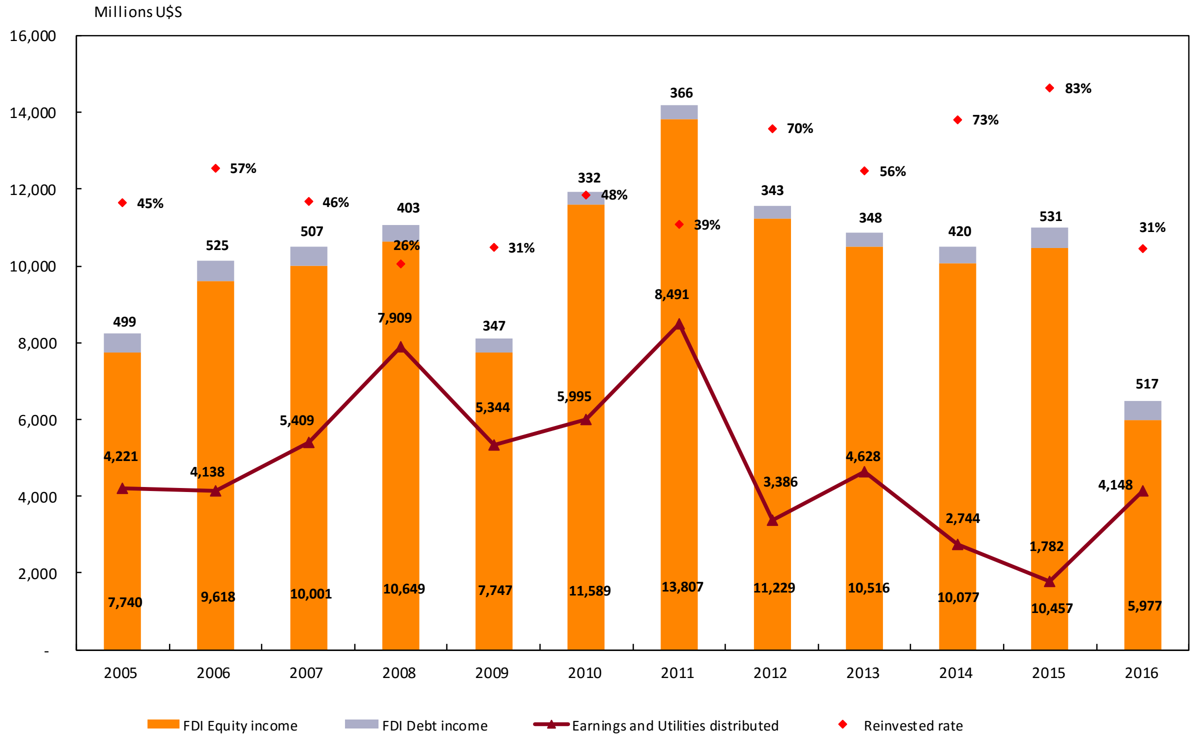
In this respect, the most affected sectors were "Manufacture of Beverages" and "Manufacture of Food Products" (-US$ 1.47 billion y.o.y), "Deposit-Taking Corporations" (-US$ 350 million y.o.y.) and "Manufacture of Motor Vehicles, Trailers and Semi-trailers" (-US$ 330 million y.o.y.).

Likewise, another feature observed in 2016 was the drop in the average reinvestment rate, which stood at 31%. This point warrants a detailed explanation. By the end of 2011, access to the foreign exchange market was restricted for the transfer of earnings, which impacted basically on two issues: (i) an increase in the debt for earnings and dividends distributed but unpaid which, on average, from 2012 to 2015, stood at a level exceeding by over 100% the average observed in the 2005-2011 period (from US$ 800 million to US$ 1.7 billion on average); and (ii) the change observed in the behavior of enterprises facing the impossibility to transfer, which were prompted to a lower distribution of earnings, resulting in an increase in the reinvestment rate (from 42% in the 2005-2011 period up to 70% in 2012-2015 period).

[23] FDI income consists of: a) the income generated by direct investments in shares and other equity (FDI equity income) and b) the interest accrued by the debt with foreign affiliated companies (FDI debt income). In turn, FDI equity income may be distributed or not; in the latter case, it is considered to be accumulated results in the enterprise's net worth (reinvestment of earnings).

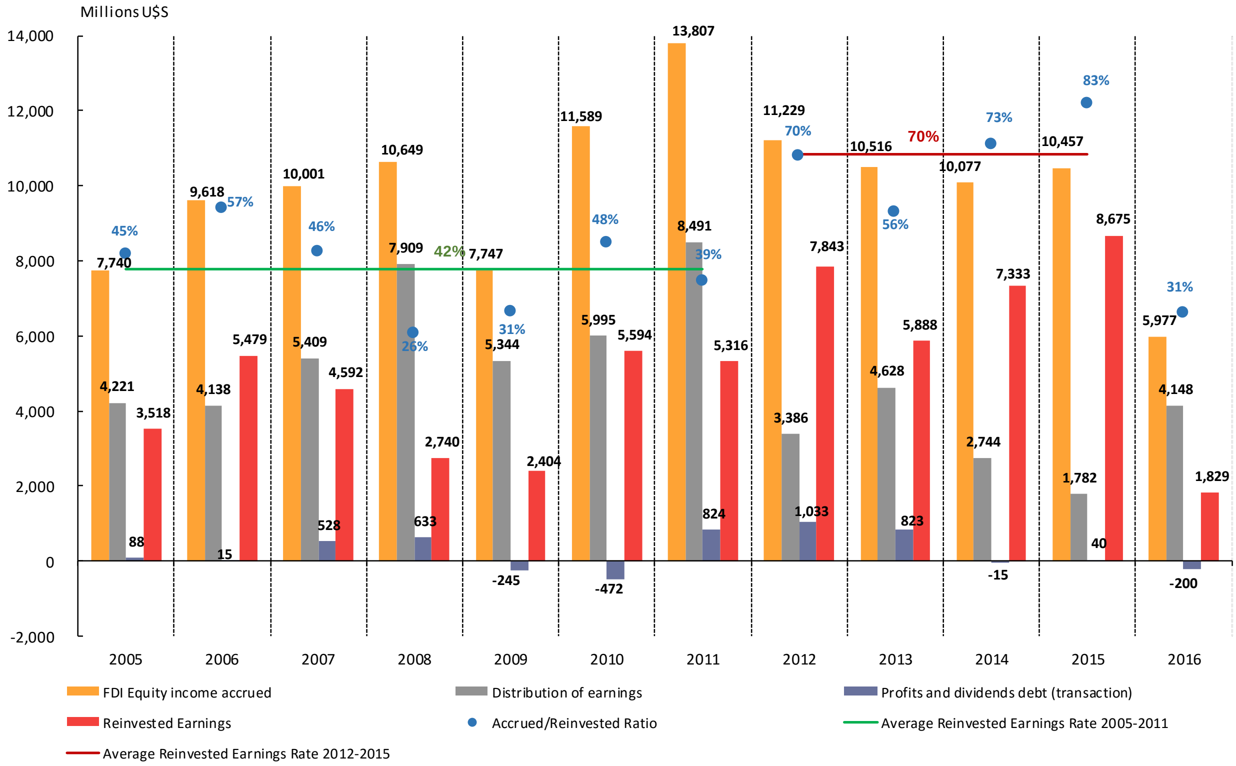
[24] The profitability on the net worth of FDI enterprises measured in pesos also posted a drop, thus confirming this trend.

Chart II.3 FDI Income and Reinvested Rate



Consequently, the result observed as from the regularization of access to the foreign exchange market started in December 2015 was likely to occur: drop in the reinvestment rate, due to the fact that enterprises decided to distribute a higher proportion of the accumulated results (which they could not distribute in previous years), and a debt net settlement for distributed but unpaid earnings and dividends for US$ 200 million (see Chart II.4).

Chart II.4 FDI Equity Income and Distribution of Earnings



As a result, reinvestment flows, with net inflows for US$ 1.83 billion, have shown one of the highest year-on-year drops along 2016. The main changes were observed in the sectors involved in “Manufacture of Food Products” (with net outflows amounting to US$ 118 million and a year-on-year drop of US$ 1.22 billion) and the sectors related to the manufacture and sale of motor vehicles (with net inflows for US$ 245 million and a year-on-year drop of US$ 850 million).

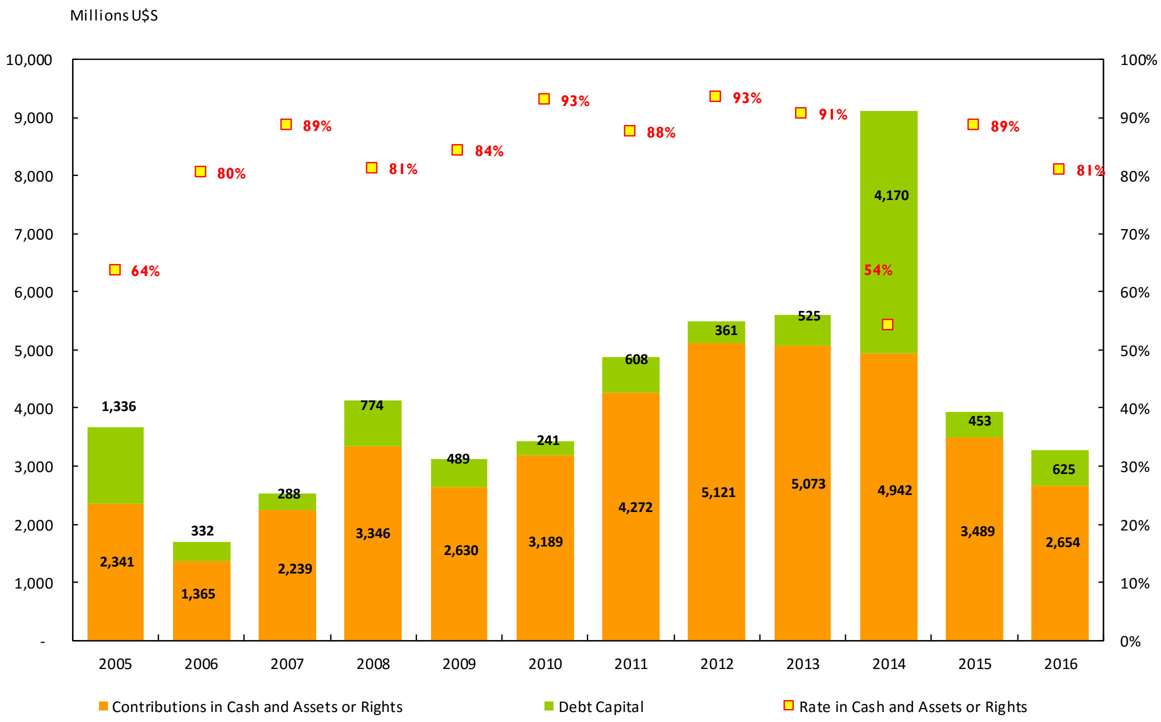
Since the resulting reinvestment ratio is lower than the average exhibited by FDI enterprises in periods prior to 2012 (42% on average), this ratio is expected to go up in the next few years and get closer to the levels seen before 2012, with the resulting recovery of reinvestment flows.

Anyway, it should be taken into account that if during the period with more restrictions to access the formal foreign exchange market (2012-2015), the valuation in US dollars of the reinvestment originally in pesos were made using the ratio between the price of a given financial asset in the domestic market, expressed in Argentine pesos, and the price of the same asset in a foreign marketplace, expressed in US dollars, then the reinvestment would have averaged US$ 5.3 billion a year.

II) c. Net capital contributions

During 2016, and at aggregate level, net capital contributions resulted in inflows for US$ 3.28 billion, down US$ 663 million against 2015 (see Chart II.5), even though the behavior was dissimilar and depended on the activity sector. FDI contributions in cash, assets or other rights reached US$ 2.65 billion in 2016, down 24% in year-on-year terms.

Chart II.5 Net Capital Contributions



On a sector-by-sector basis, enterprises operating in the sector of "Extraction of Crude Petroleum and Natural Gas" received contributions for US$ 951 million, up 30% y.o.y. Other sectors that stand out because of their dynamism were "Telecommunications," with net contributions for US$ 375 million, the maximum amount on record received by the sector since 2005, and "Deposit-Taking Corporations, except for the Central Bank" with contributions for US$ 143 million, related to activity expansion projects of this sector in the country. In general terms, most of the remaining sectors had contributions below the figures recorded in 2015.

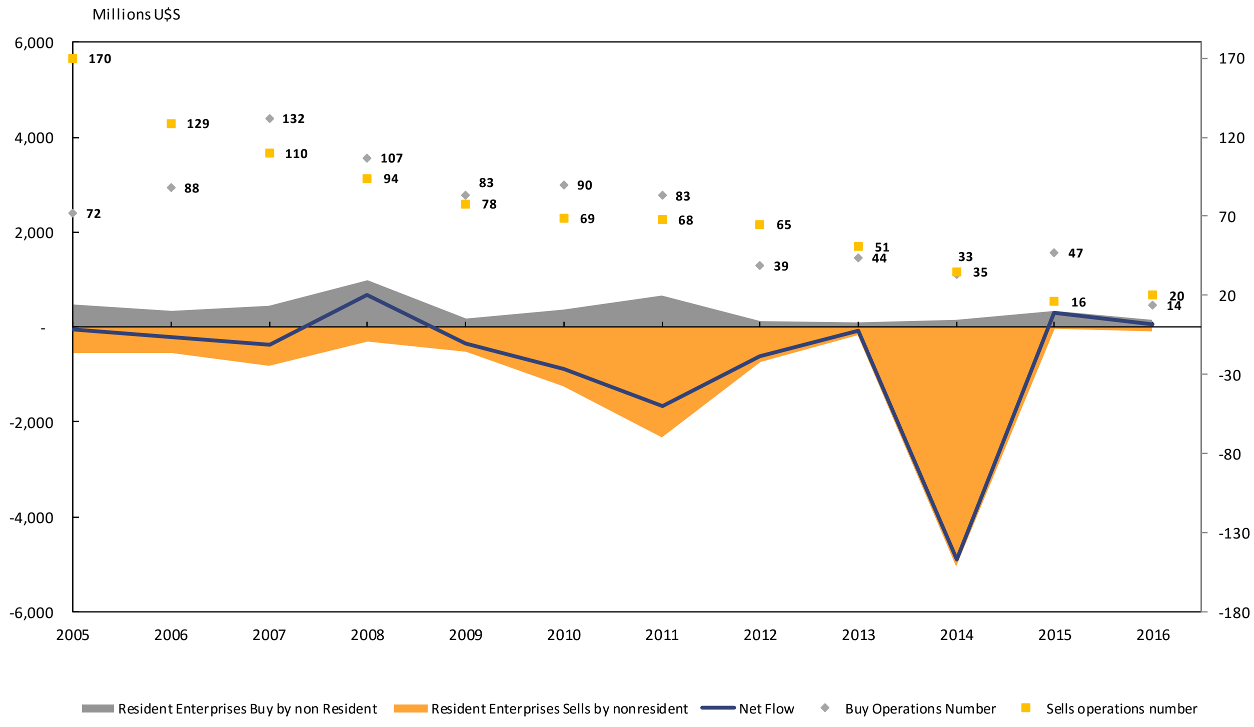
The data available as of the date of publication of this report would seem to signal that nonresident direct investment inflows settled through the exchange market in 2017 stand at the same level as in 2016, even though an increase would be observed in the number of recipient enterprises, from 659 between January and September 2016 up to 886 in the same period of 2017.

II) d. Transfers of shares and of equity[25]

Since the beginning of the series in 2005, a declining trend has been observed in the number of net acquisition of equity by nonresident direct investors, accompanied by a decrease in the amounts involved and, except for specific cases, they were not an important component of the direct investment flows in recent years. In 2016, there were net inflows from transfers of direct investment equity for the sum of US$ 56 million. This net flow consisted in 14 purchases of local enterprises by nonresidents for US$ 139 million and 20 sales of local enterprises by nonresidents for US$ 84 million.

[25] The flows for transfers of shares and equity derive from changes of ownership between direct investors and resident investors. Transactions between nonresidents do no entail direct investment net flows. However, these transactions may affect the positions by country when purchaser and seller belong to different countries.

Chart II.6 FDI Flows –Transfers of Shares



II) e. Debt instruments[26]

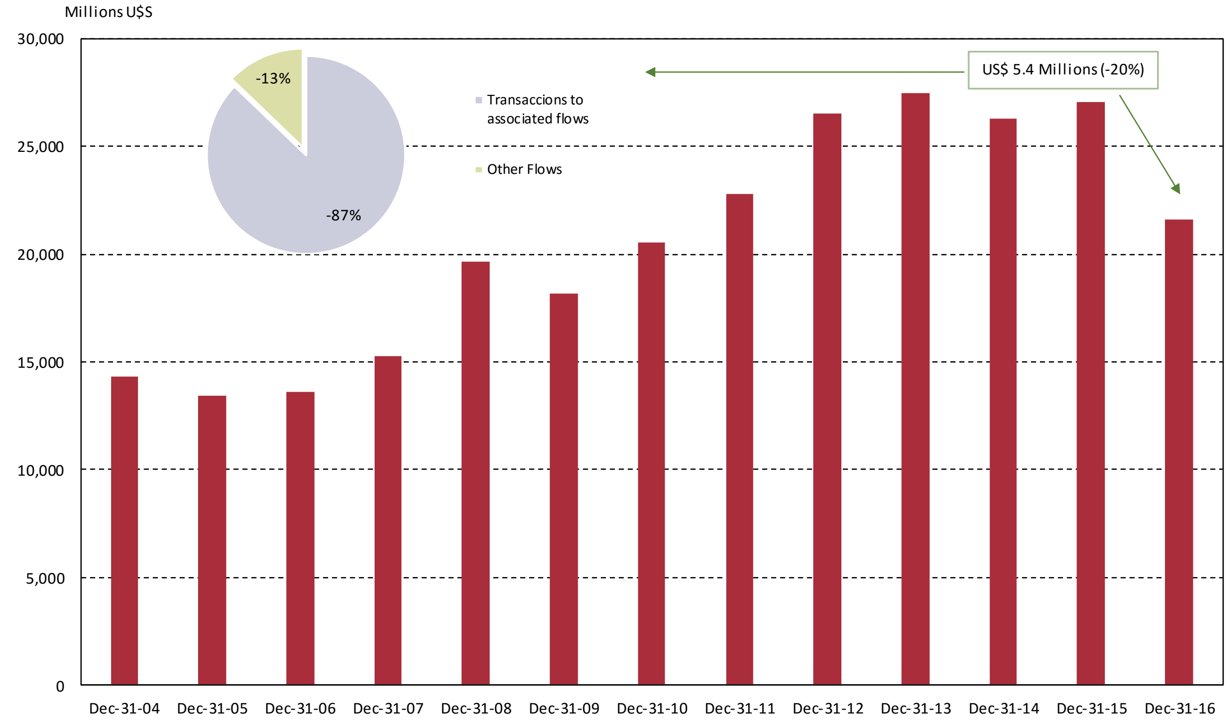
During 2016, direct investment debt positions went down by US$ 5.46 billion, resulting from net settlements for US$ 4.77 billion and drops related mainly to changes in the exchange rate affecting debts denominated in currencies other than the US dollar for US$ 701 million (see Chart II.7).

As from the end of 2011, the stringent formal controls adopted in terms of foreign exchange and foreign trade affected the evolution of the private sector external debt, resulting mainly in increases in the commercial liabilities positions (imports of goods and services). As pointed out above, since late 2015, the Central Bank of Argentina adopted a series of measures tending to give more freedom to capital movements, which impacted on external indebtedness flows. In this respect, regulations on the payment of imports of goods and services, income, current transfers and non-financial non-produced assets were simplified, while regulations on inflows and financial debt settlements became more flexible[27].

[26] For more Information about private sector external debt, see the Private Sector External Debt Report available in the BCRA’s web page (click here).

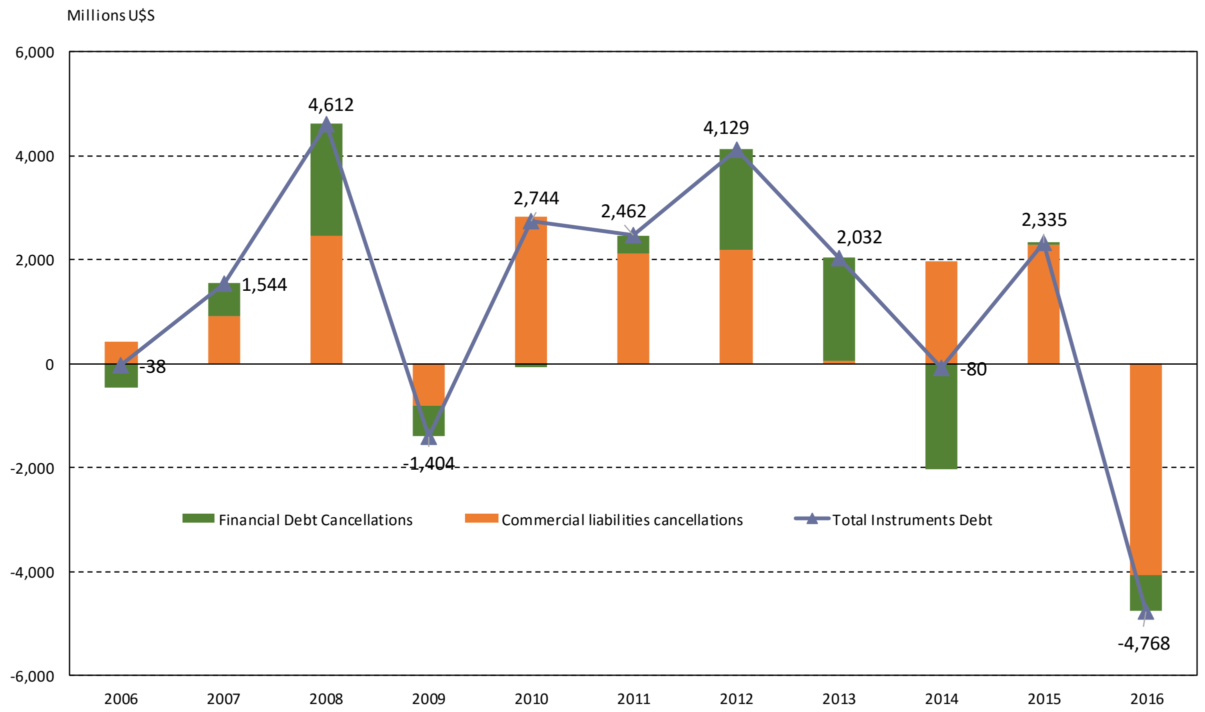
[27] By virtue of Communication “A” 5850, dated December 17, 2015, a schedule was established for the total release of debt payments for imports of goods and services prior to December 16, 2015, effective as from June 2016 which was later taken to April 2016 by virtue of Communication “A” 5955. Likewise, natural and legal personas were authorized to purchase foreign currency and other external assets for an amount of up to US$ 2 million per month, and the requirement of registration and validation under the Computerized System of Foreign Exchange Transactions of the Federal Administration of Public Revenues (*Administración Federal de Ingresos Públicos (AFIP)*) was eliminated. On the other hand, Communication “A” 5963 extended to US$ 5 million/month the limit for the purchase of freely-available external assets by residents, which would be entirely relased in August by virtue of Communication “A” 6037. This Communication states that foreign exchange transactions can be made under a sworn statement of the heading corresponding to the transaction, except when specific requirements are established, thus largely eliminating the obligation to justify each exchange transaction by submitting documents.

Chart II.7 Direct Investment Debt Positions



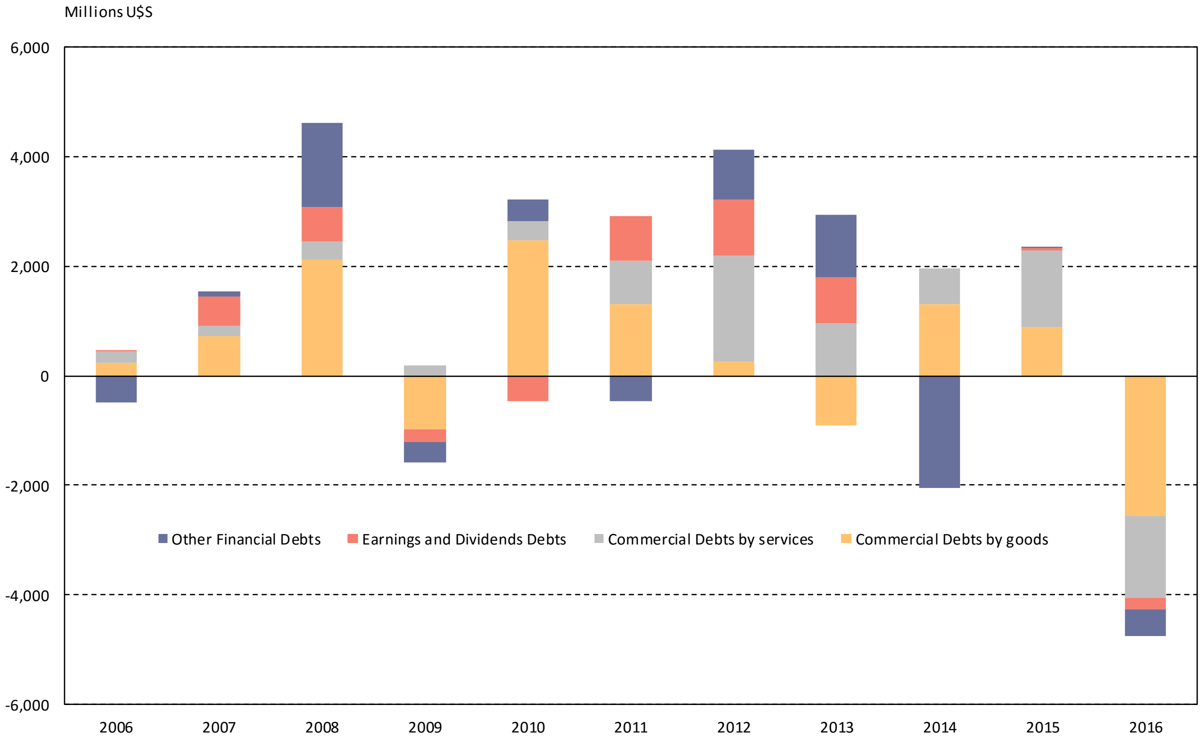
In this context, a debt reduction process started in December 2015, the effects of which became more visible during 2016. A similar evolution was observed in the financing granted by direct investors to their affiliated enterprises in the country. As a result, throughout 2016, net cancellations of this type of debt reached a historical maximum in the series surveyed, with net payments of commercial liabilities for US$ 4.06 billion and of financial liabilities for US$ 705 million (see Chart II.8).

Chart II.8 Transaction Flows of Direct Investment Debt by Type of Transaction



Commercial liabilities cancellations were mainly related to debt net payments for the import of goods (US$ 2.83 billion) and of services (US$ 1.51 billion); in turn, financial debt cancellations during 2016 were mainly related to net payments of financial loans (US$ 483 million) and liabilities for earnings and dividends for US$ 200 million (see Chart II.9).

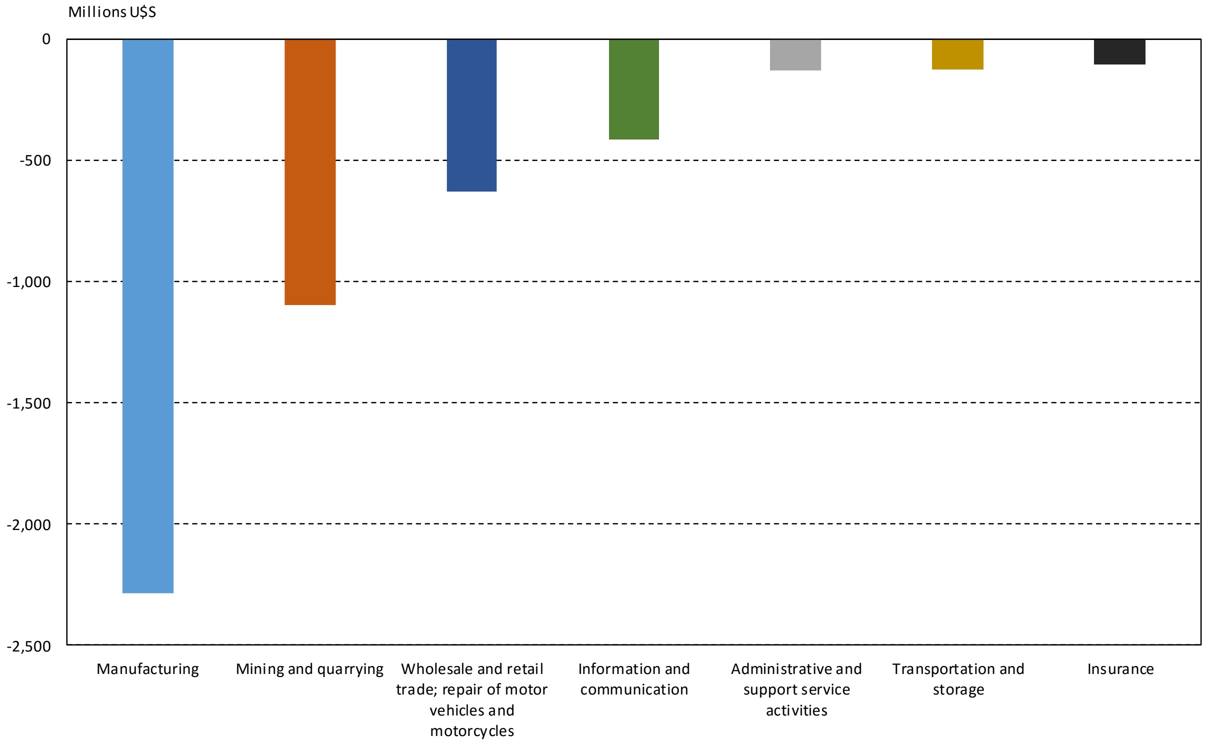
Chart II.9 Transaction Flows of Direct Investment Debt by Type of Transaction



The main sectors[28] with net cancellations during 2016 include "Manufacturing", with a drop of US$ 2.28 billion, followed by "Mining and Quarrying" for US$ 1.1 billion, "Wholesale and Retail Trade, Repair of Motor Vehicles and Motorcycles" for US$ 630 million and "Information and Communication" for US$ 413 million (see Chart II.10).

[28] At letter level, according to the National Classification of Economic Activities (CLANAE 2010).

Chart II.10 Transaction Flows of Direct Investment Debt by Economic Activity Sector - 2016



In the "Manufacturing" sector, the cancellations made by the subsectors "Manufacture of Motor Vehicles, Trailers and Semi-Trailers" for US$ 891 million, "Manufacture of Computer, Electronic and Optical Products", for US$ 790 million and "Manufacture of Substances and Chemical Products" for US$ 361 million are to be noted.

III) FDI Gross Liability Position

As of December 31, 2016, the FDI estimated gross liability position[29] in Argentine enterprises amounted to US$ 74.92 billion, down 8.5% y.o.y., and accounting for 14 percentage points (p.p.) of GDP[30], within a context of a 22% nominal exchange rate depreciation[31] against the year before. Out of this total, US$ 53.33 billion corresponded to equity in the value of enterprises' net worth, standing at a level similar to that of last year, and US$ 21.59 billion corresponded to direct investment debt liabilities, which accounted for virtually the entire drop of the total liability position (see Chart III.1).

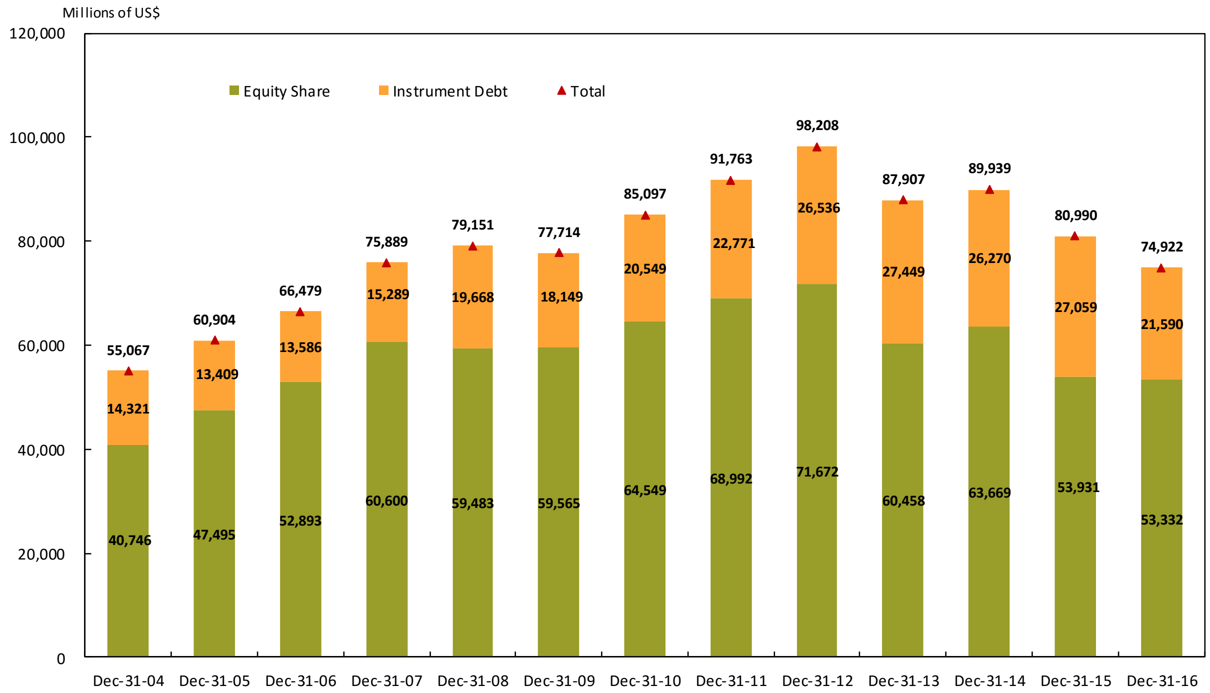
[29] FDI gross liability position in enterprises is an estimate of the value of nonresidents' direct investments in Argentine enterprises, calculated on the basis of the proportional equity values –the equity of direct investors in the enterprise multiplied by the net worth of the latter– and the residual value of the external liabilities of parent companies and their affiliated enterprises.

Annex I includes a detail of definitions of concepts and other methodological aspects used in data preparation, in addition to those included herein.

[30] Gross Domestic Product measured in current pesos and published by the National Institute of Statistics and Censuses (*Instituto Nacional de Estadísticas y Censos (INDEC))*. To calculate GDP in dollars, the reference exchange rate (annual average) published by the BCRA was used.

[31] Reference exchange rate as of December 31 each year, published by the BCRA (Communication "A" 3500).

Chart III.1 FDI Gross Liability Position in Argentina



The external debt of FDI enterprises with their parent and affiliated enterprises recorded a drop of US$ 5.47 billion, losing share in the private sector's total external financing (the direct investment debt accounted for 36% of the external debt total stock, down 5 p.p. against the figure recorded in 2015). As explained above, this drop in the debt with affiliated enterprises resulted from the private sector's debt reduction process started by late 2015.

As observed also in 2015[32], the drop of the FDI liability position was due to changes in the exchange rate and other adjustments[33] for the sum of US$ 7.36 billion, partially offset by inflows from financial transactions amounting to US$ 395 million in 2016 (See Chart III.1).

Chart III.1 Stocks and flows Reconciliation
Millions U$S

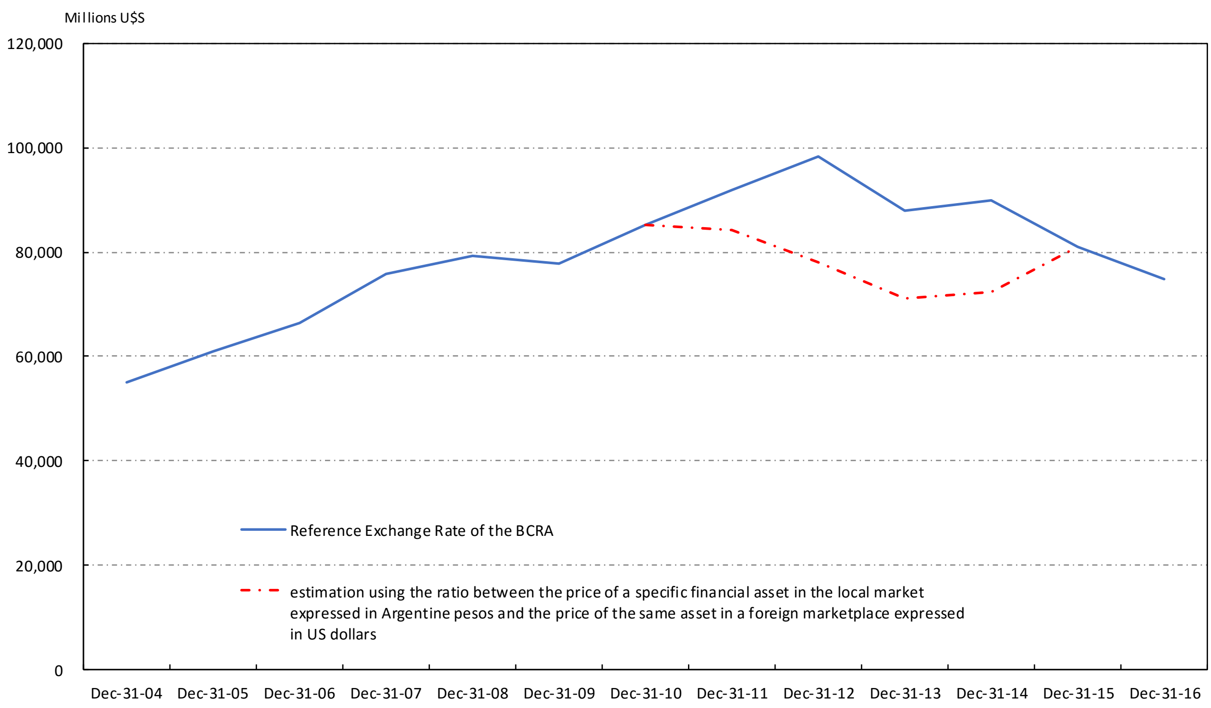
	Stock Variations		
FDI Position as of Dec-31-15	Financial Transaction	Other Variations	FDI Position as of Dec-31-16
80,990	395	-6,463	74,922

It should be noted here that liability positions originally denominated in pesos were converted into their equivalent amount in US dollars at the Reference Exchange Rate of the BCRA (Communication A 3500) of the last business day of the period. Chart III.2 illustrates the effect that could derive from valuing such positions using the ratio between the price of a specific financial asset in the local market expressed in Argentine pesos and the price of the same asset in a foreign marketplace expressed in US dollars during the years when the administration of payments to foreign countries was effective.

[32] According to the provisions of the IMF's Balance of Payments and International Investment Position Manual, Sixth Edition, the changes in holdings position between two specific dates may be due to financial flows, changes in the exchange rate, changes in prices, and other changes. Financial transaction flows are recorded in the financial account of the Balance of Payments, while changes in holdings not derived from transactions, are recorded in the reconciliation accounts. The nominal change between the domestic currency relative to the account currency (US dollar) was 22% during 2016. The latter, applied to financial statements expressed in domestic currency, was the reason behind the higher proportion of negative changes recorded in the FDI gross liability position.

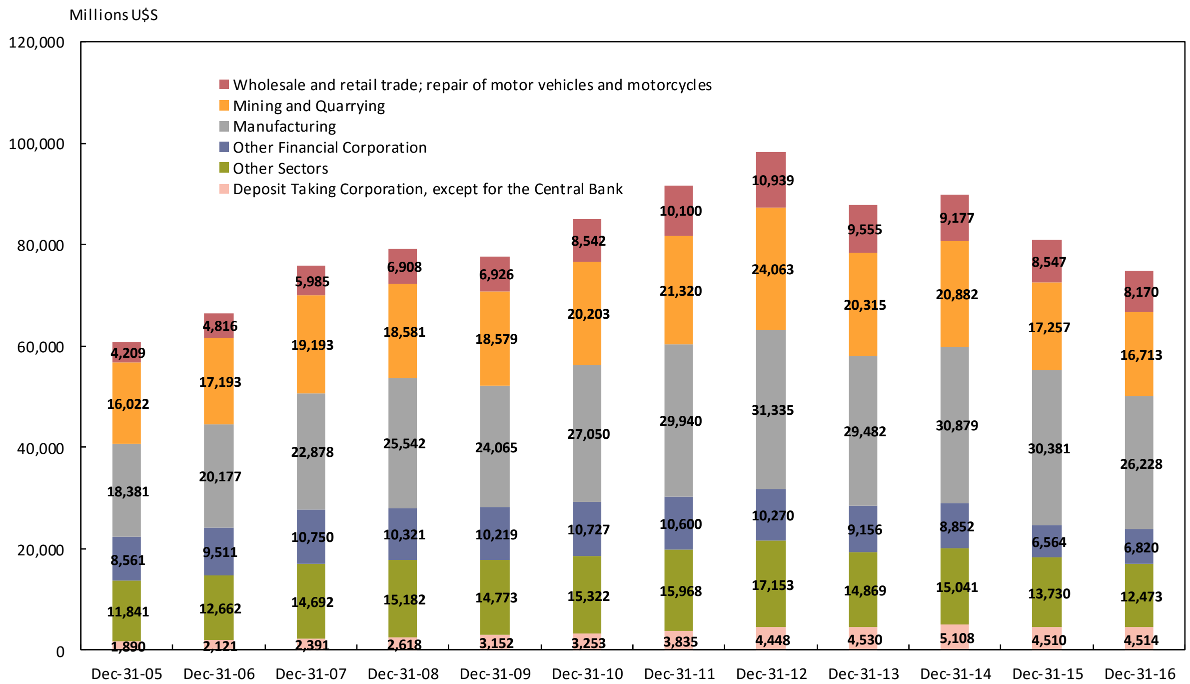
[33] The other adjustments basically include the results by holding due to the changes in prices and exchange rates and other extraordinary results, according to the "Operating Income Standard" explained in Annex I.

Chart III.2 FDI Gross Liability Position in Argentina



On a sector-by-sector basis[34], the "Manufacturing" sector continues to be the main recipient of direct investment, with a position as of December 31, 2016, of US$ 26.23 billion, despite its 16% y.o.y. drop. Out of this total, 69% corresponded to equity in enterprises and the remaining 31% to indebtedness with affiliated enterprises. In order of relevance, this sector was followed by "Mining and Quarrying", with a position of US$ 16.71 billion; "Wholesale and Retail Trade; Repair of Motor Vehicles and Motorcycles", with a stock of US$ 8.17 billion and "Other Financial Corporations" with a stock of US$ 6.82 billion (see Chart III.3).

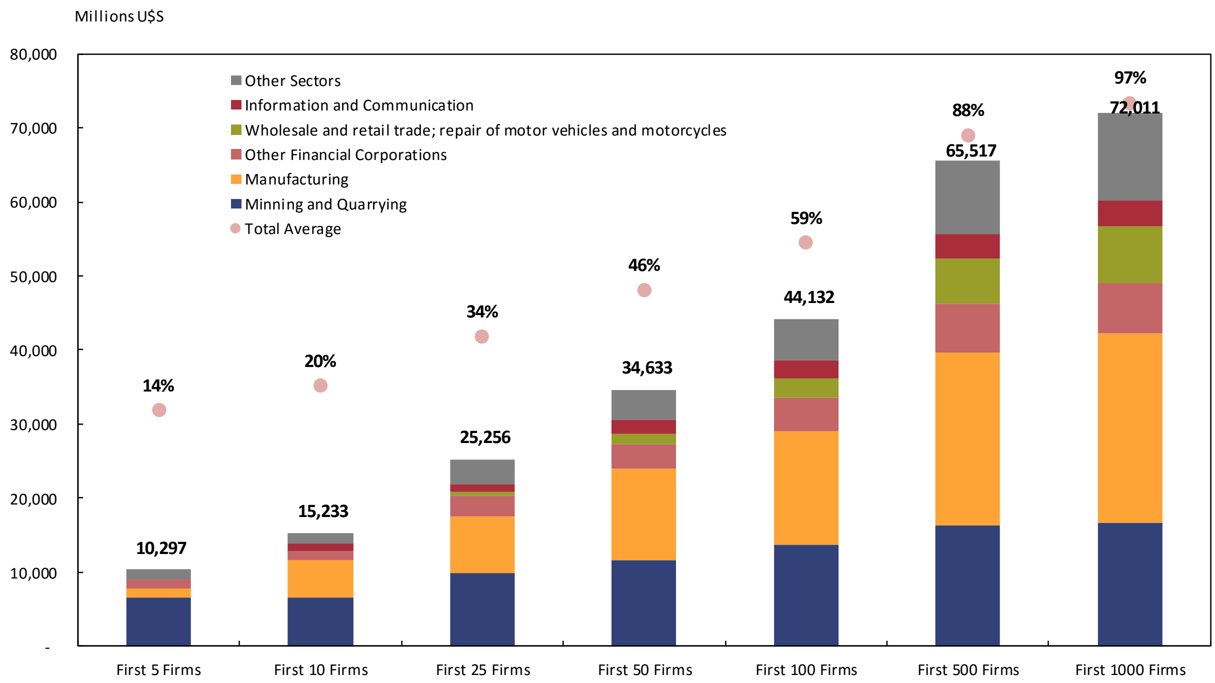
Chart III.3 FDI Gross Liability Position in Argentina By Main Economic Sector



[34] At letter level, according to the National Classification of Economic Activities (CLANAE 2010).

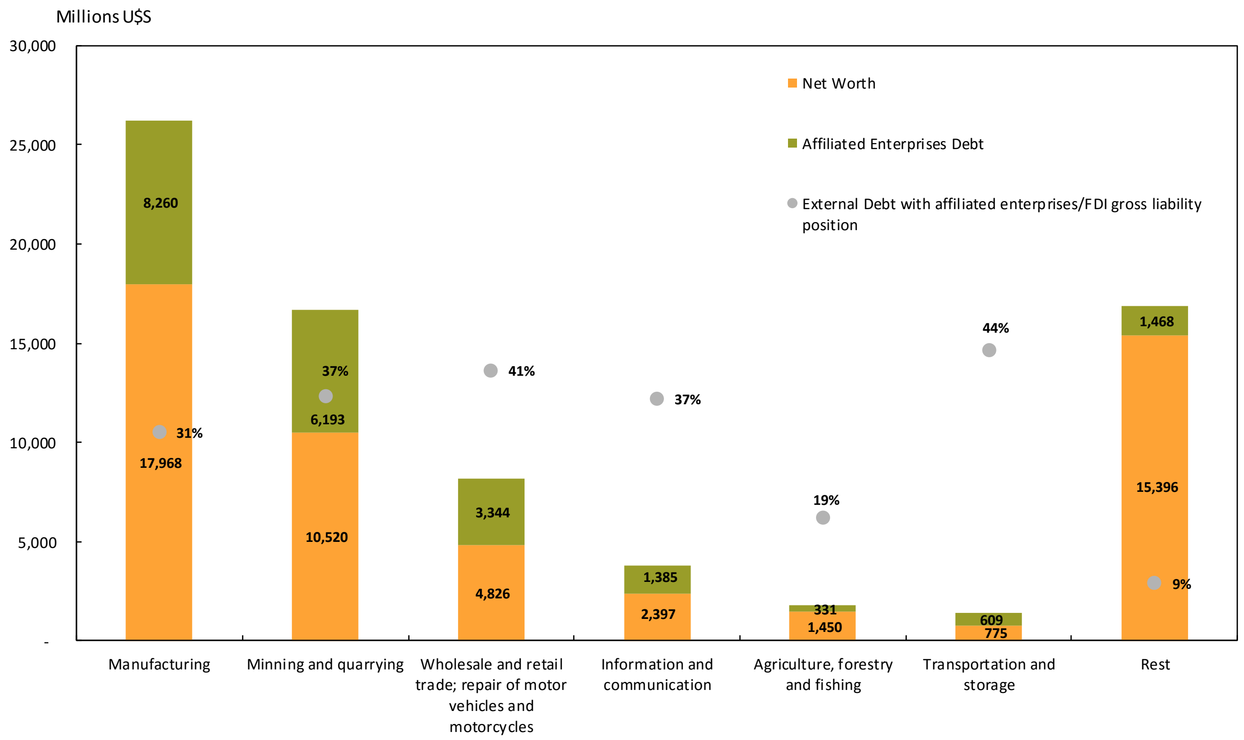
By the end of 2016, the gross liability position was concentrated in a few enterprises. The first five firms accounted for 14% of the total position of the period. In this respect, the first 100 enterprises account for nearly 59% of the total estimated position (see Chart III.4). The sectors with the highest share in this concentration (in all strata) are "Mining and Quarrying" and "Manufacturing."

Chart III.4 Concentration of the FDI Gross Liability Position as of December 31, 2016



As of December 31, 2016, the external indebtedness with affiliated enterprises accounted for 29% of the FDI gross liability position, down 4 p.p. against 2015, with ranges between 20% and over 40%.

Chart III.5 External Indebtedness with affiliated enterprises as % of FDI gross liability position

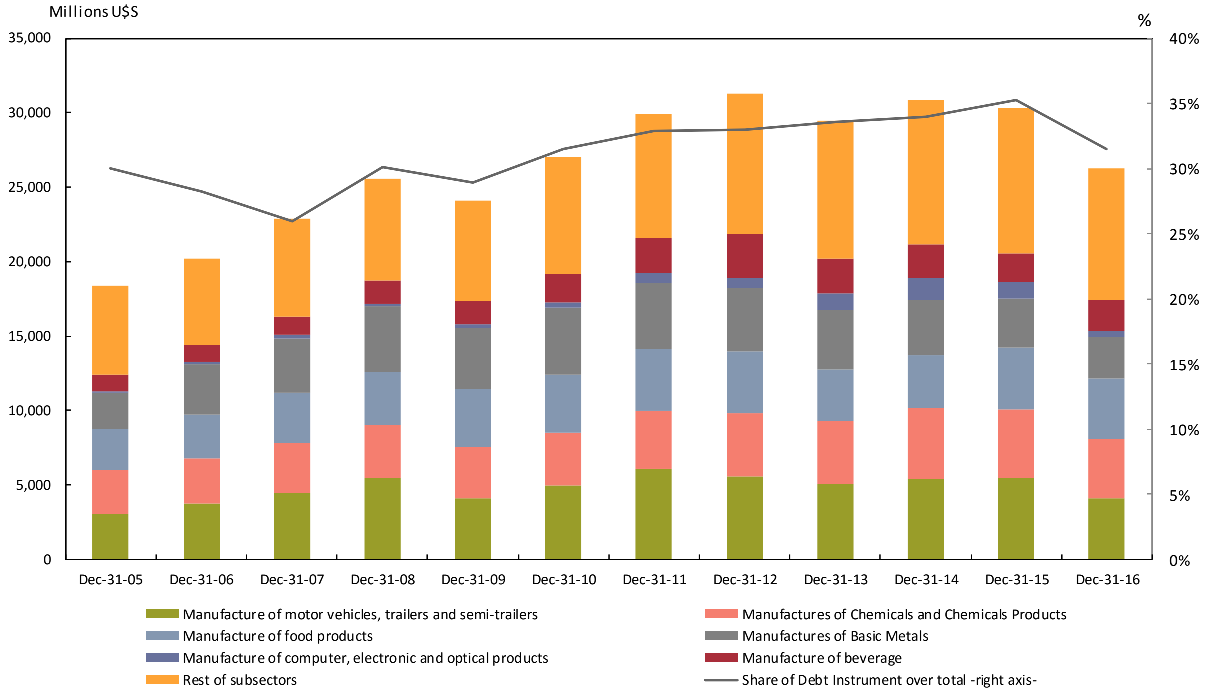


III) a. Activity sector of the recipient enterprise[35]

In this section, an analysis will be made on a subsector-by-subsector basis of the 3 main activity sectors, taking into account the FDI total liability position as of December 31, 2016, which sectors are: “Manufacturing,” “Mining and Quarrying” and “Wholesale and Retail Trade; Repair of Motor Vehicles and Motorcycles.” It is worth pointing out that these 3 sectors account for 68% of the total position by the end of 2016.

Within the “Manufacturing” sector (which accounted for 35% of FDI), “Manufacture of Food Products” stood out with a position of US$ 4.08 billion as of December 31, 2016 and a 1% drop in year-on-year terms. Such sector was followed by “Manufacture of Motor Vehicles, Trailers and Semi-trailers” and “Manufacture of Substances and Chemical Products” with a position of US$ 4.06 billion and US$ 4 billion, respectively (see Chart III.6).

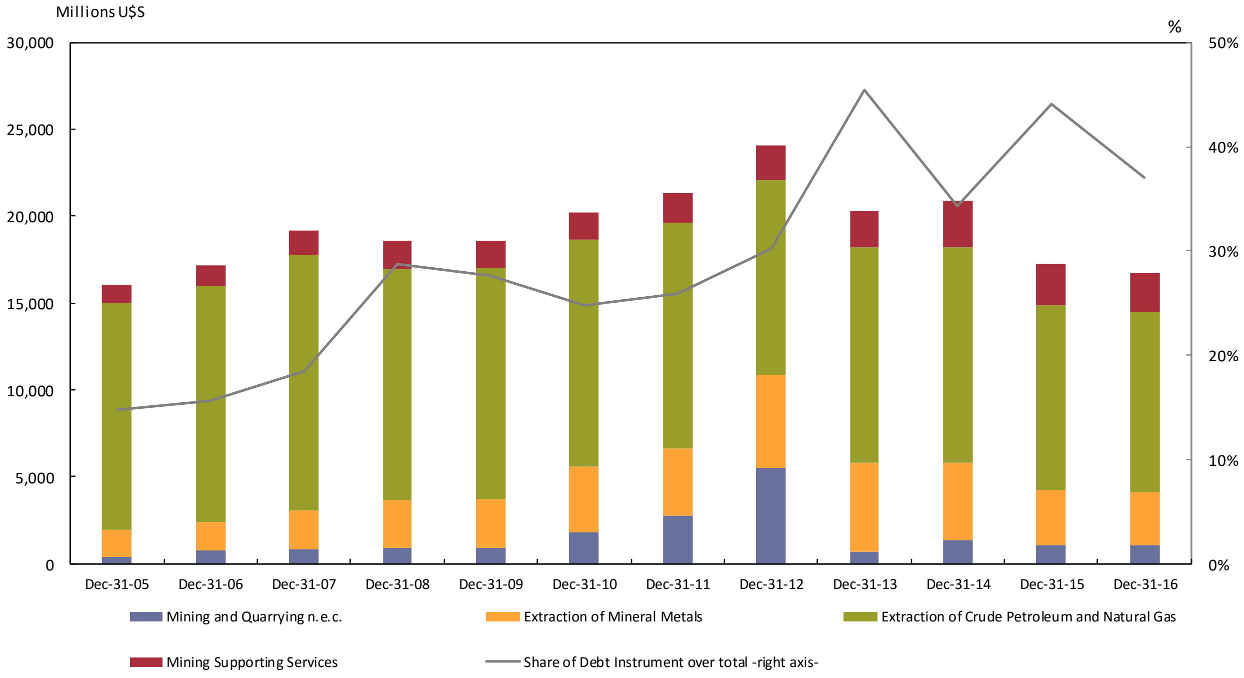
Chart III.6 FDI Gross Liability Position – Manufacturing



In turn, in order of relevance, the “Mining and Quarrying” sector followed, accounting for 22% of the total FDI stock for 2016. As previously stated, this sector reached a position of US$ 16.71 billion, basically supported by “Extraction of Crude Petroleum and Natural Gas” with a gross liability position of US$ 10.37 billion and a 3% y.o.y. drop (see Chart III.7).

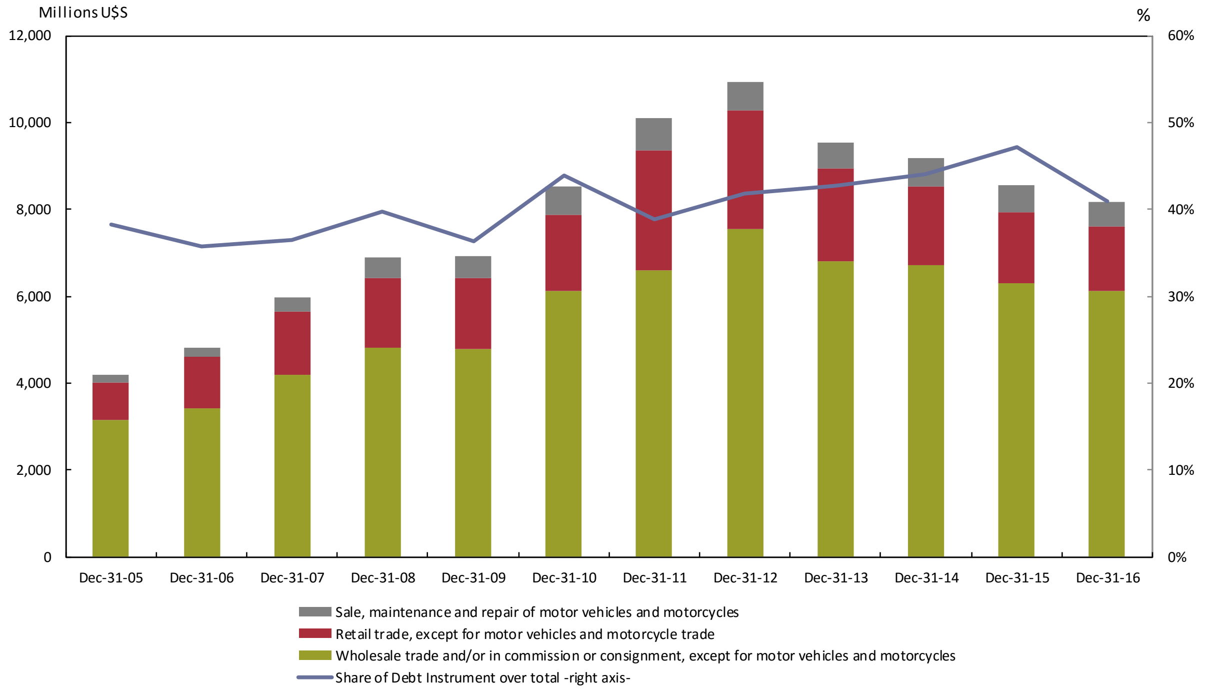
[35] The classification by sectors was made taking into consideration the main activity reported in the Survey by the enterprise receiving the investment. At two-digit level, according to the National Classification of Economic Activities (CLANAE 2010).

Chart III.7 FDI Gross Liability Position in Argentina – Mining and Quarrying



Finally, it should be noted that within the sector "Wholesale and Retail Trade; Repair of Motor Vehicles and Motorcycles" (11% of FDI), "Wholesale Trade and/or in Commission or Consignment, except for Motor Vehicles and Motorcycles" stood out and accounted for 75% of the sector, with a position of US$ 6.14 billion and posting a 3% y.o.y. drop (see Chart III.8).

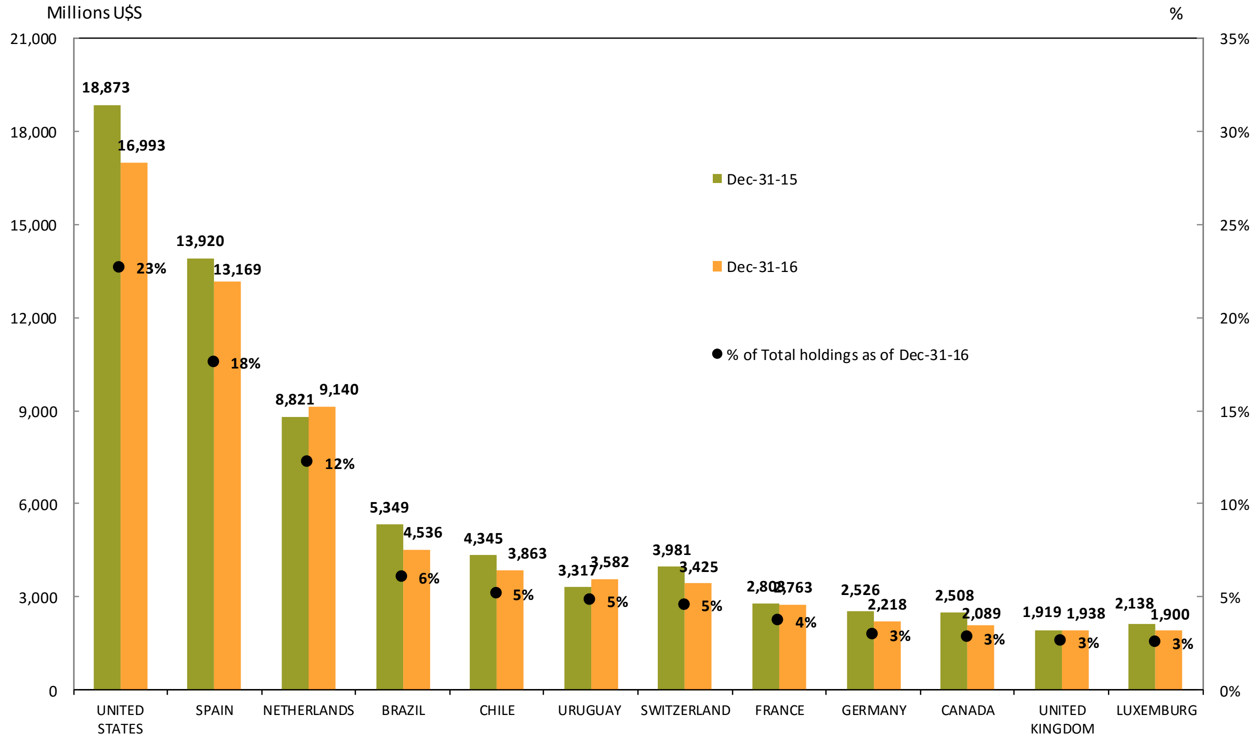
Chart III.8 FDI Gross Liability Position – Wholesale and Retail Trade; Repair of Motor Vehicles and Motorcycles



III) b. FDI gross liability position by investment geographical origin – First holding level[36]

As regards source countries, United States was again the main source of FDI in Argentina, with a stock of US$ 16.99 billion, which accounted for 23% of total holdings as of the end of 2016, even though the US position turned out to be 10% lower than recorded in 2015. United States was followed by Spain (US$ 13.17 billion), Netherlands (US$ 9.14 billion), Brazil (US$ 4.54 billion) and Chile (US$ 3.86 billion). It is worth stating that both Netherlands and Chile posted year-on-year increases of 4% and 2%, respectively, whereas the other countries recorded drops (see Chart III.9).

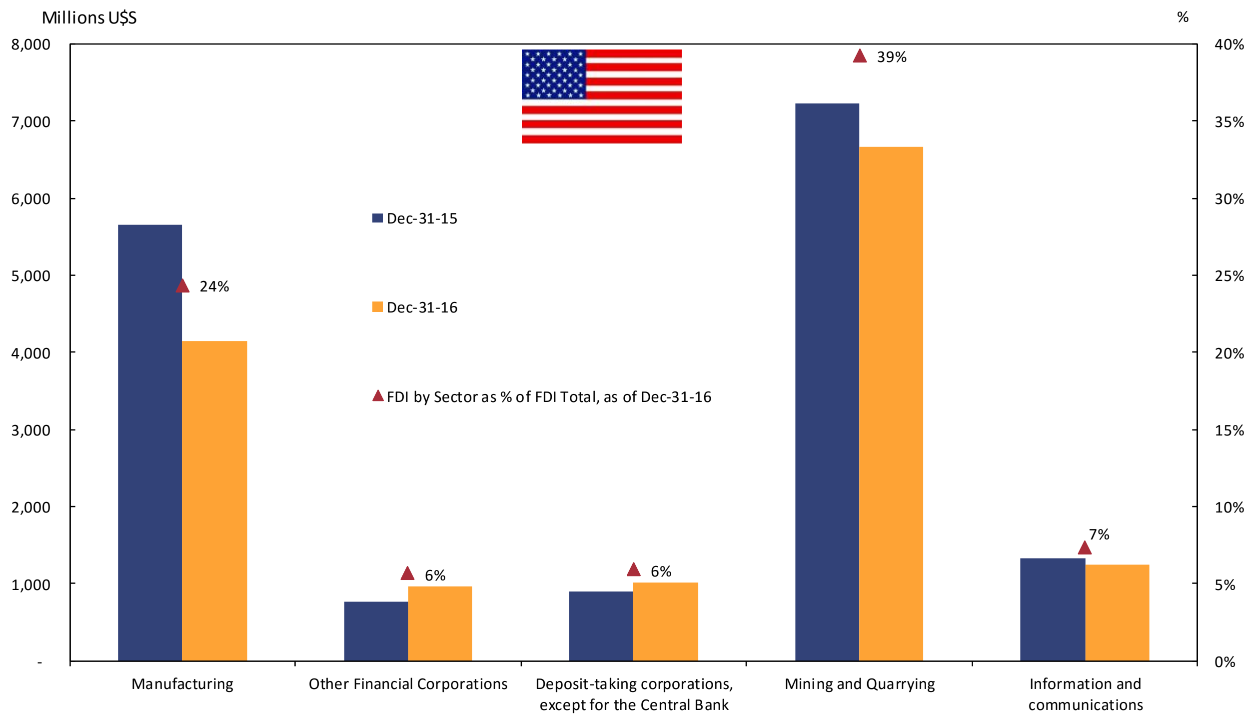
Chart III. 9 Gross Liability position - Main Countries



The FDI from the United States was mainly addressed to the "Mining and Quarrying" sector which accounted for 39% of the total, with a position of US$ 6.67 billion. In order of relevance, it was followed by "Manufacturing" with a 24% share and a position of US$ 4.14 billion (see Chart III.10).

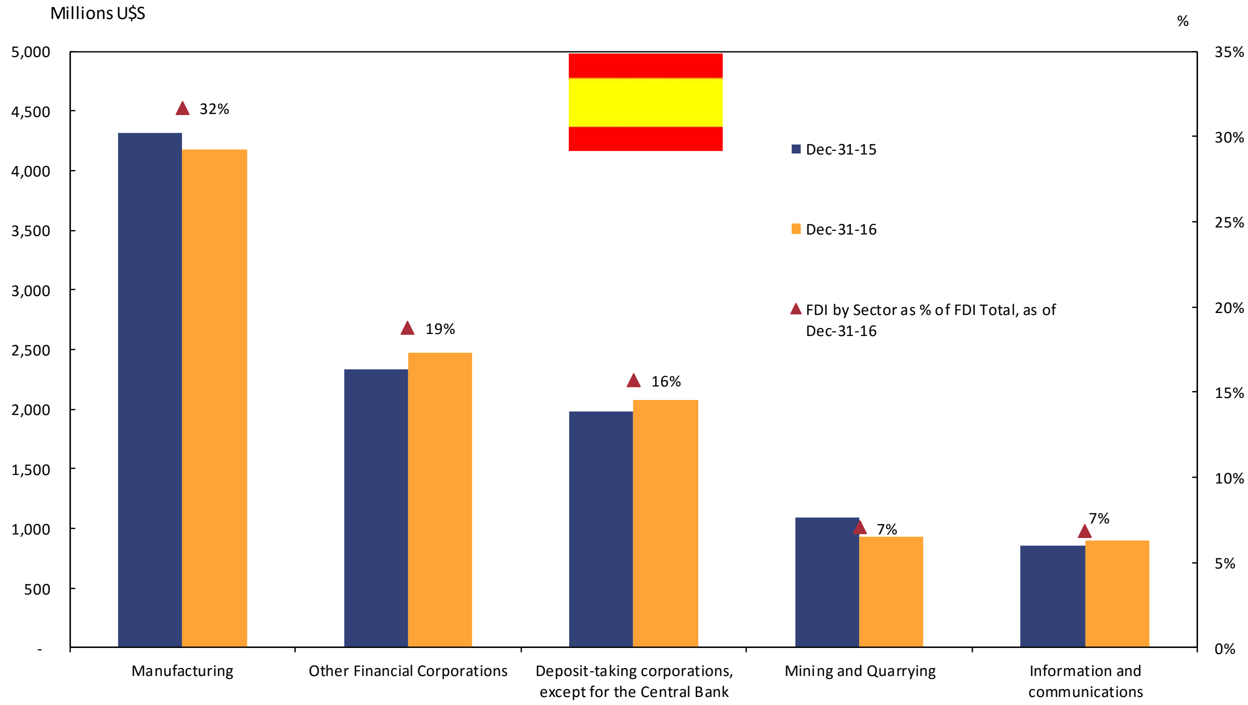
[36] The first holding level considers that the source of direct investment is the country of residence of the immediate direct investor, which is the direct owner of equity in the resident enterprise. The statistical annex available in section "Publications and Statistics", subsection "Statistics/External Sector/Direct Investments in Enterprises," of the BCRA's web page presents an in-depth breakdown of the FDI gross position by source country and activity sector (click here). In addition, such section provides the reports for previous years.

Chart III. 10 Gross Liability Position - Main Economic Activity Sector



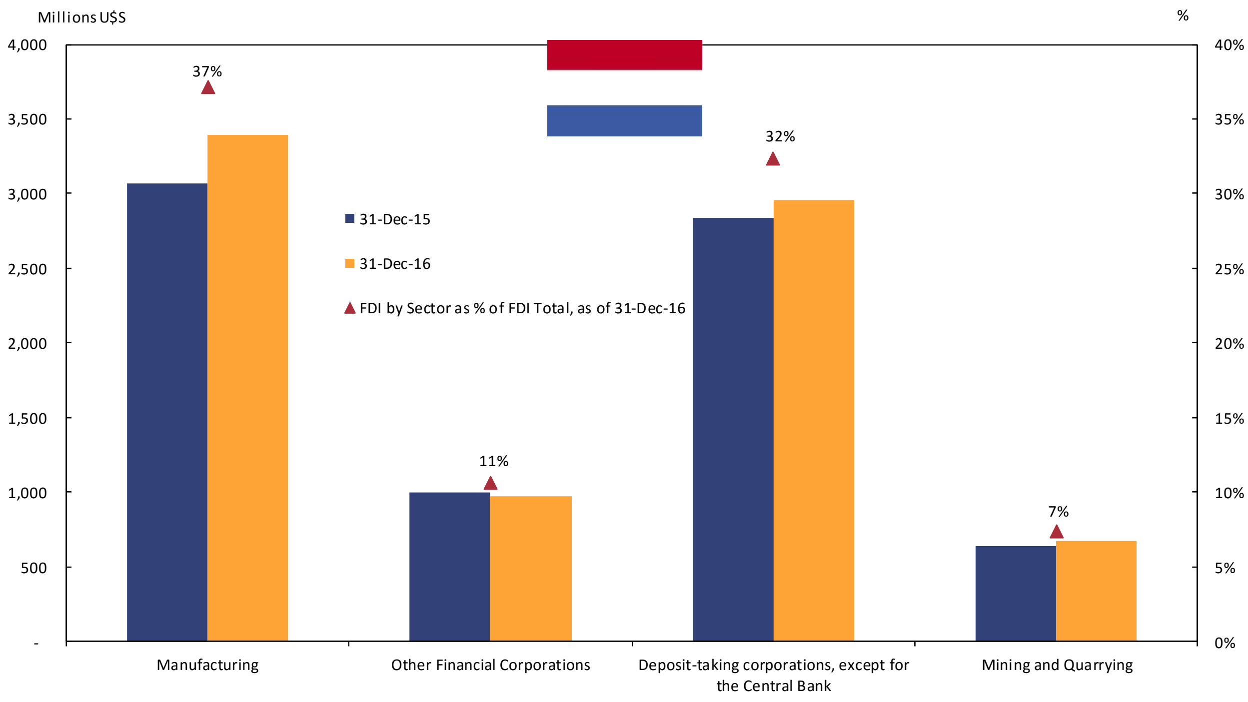
In turn, as of December 31, 2016, Spain accumulated a stock of US$ 13.17 billion, thus posting a 5.4% y.o.y. decrease. On a sector-by-sector basis, "Manufacturing," stood first, accounting for 32% of Spain's FDI position, and it was followed by "Other Financial Corporations" with a 19% share on the total (see Chart III.11).

Chart III. 11 Gross Liability Position - Main Economic Activity Sector



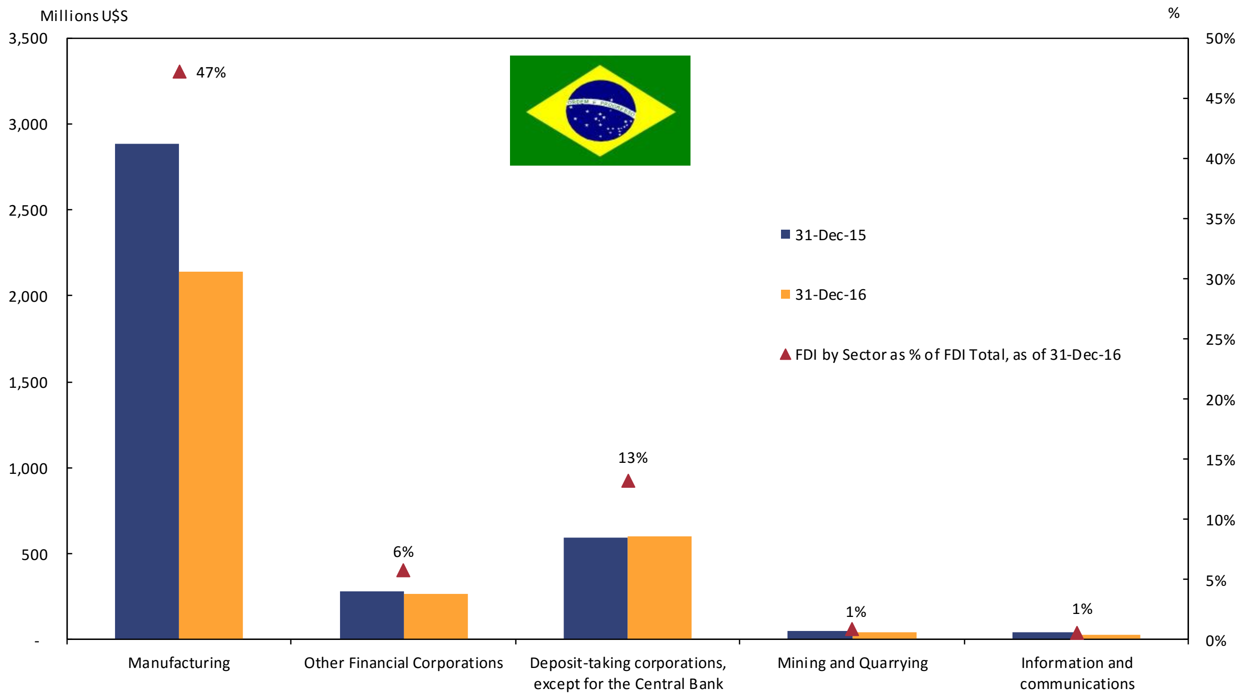
Besides, Netherland stood as the third FDI creditor as of December 31, 2016, with a position of US$ 9.14 billion, posting a 3.6% y.o.y. increase. The "Manufacturing" sector concentrated 37% of investments from such country and was followed by "Deposit-Taking Corporations, except for the Central Bank" with a 32% share on the total (see Chart III.12).

Chart III. 12 Gross Liability Position - Main Economic Activity Sector



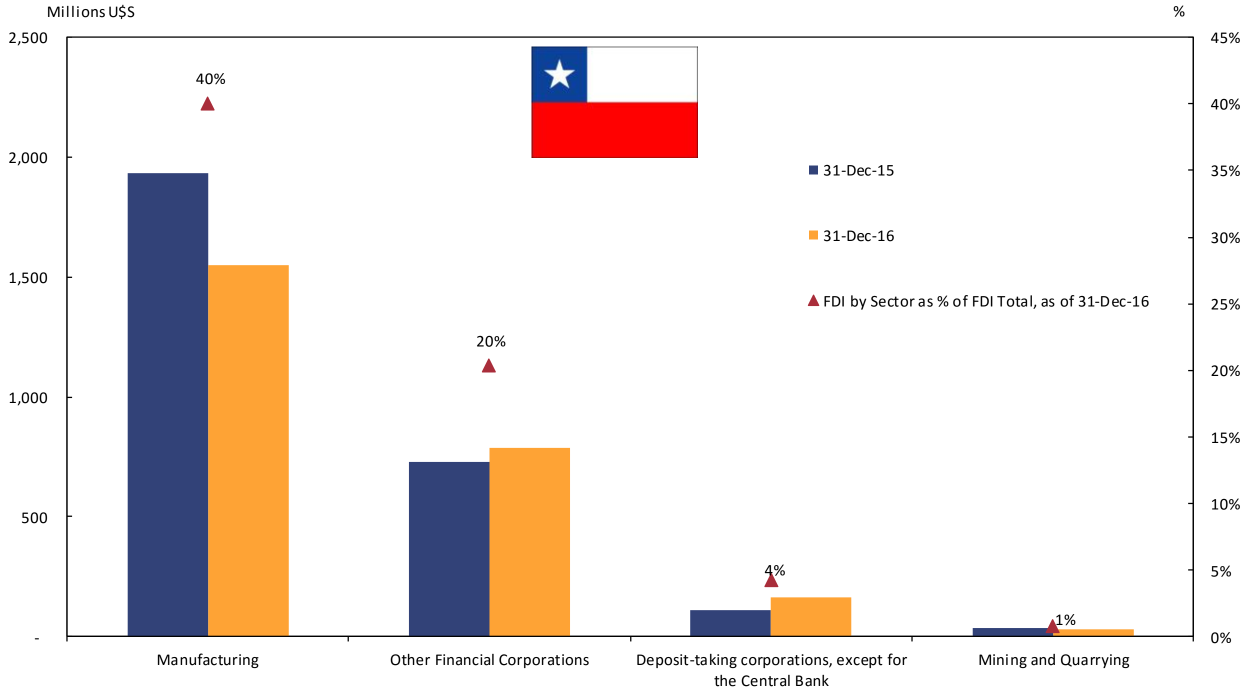
Brazil accounted for 6% of Argentina's FDI position as of December 31, 2016 for an amount of US$ 4.54 billion (15% y.o.y. decrease). The "Manufacturing" sector basically concentrated the largest portion of the position jointly with "Deposit-Taking Corporations, except for the Central Bank" (47% and 13%, respectively, see Chart III.13).

Chart III. 13 Gross Liability Position - Main Economic Activity Sector



Finally, as of December 31, 2016, Chile accumulated an FDI gross position of US$ 3.86 billion, posting a 1.7% y.o.y. increase. On a sector-by-sector basis, “Manufacturing” led the position with a 40% share, followed by “Other Financial Corporations”, which concentrated 20% of the total position.

Chart III. 14 Gross Liability Position - Main Economic Activity Sector



ANNEX I: Definitions and other explanations

The direct investment in enterprises reflects the objective by an entity residing in one economy (direct investor) to obtain permanent equity in an entity residing in another economy (direct investment enterprise); and this comprises not only the initial transaction which establishes the relationship between the investor and the direct investment enterprise, but also all transactions that subsequently take place between them.

In this sense, the direct investment in enterprises consists of the capital provided to a direct investment enterprise by the direct investor, either directly or through other enterprises affiliated to it, the earnings of the direct investment enterprise corresponding to the direct investor which have not been distributed as dividends, and the debts between the direct investor and the direct investment enterprise[37].

The distinctive characteristic of direct investment is the investor's actual involvement in the management of the direct investment enterprise. In general, the definition of direct investment enterprise refers to an enterprise having at least one investor residing in another economy that holds 10% or more of equity.

In this report, FDI enterprises are all enterprises that, in the framework of the Direct Investment Survey (Communication "A" 4237) implemented by this Central Bank, have reported that they have at least one investor residing in another economy that held 10% or more of such enterprise's equity[38].

In addition, when calculating direct investment external debt liabilities, the liabilities of all enterprises that reported to have this type of debt were taken into consideration.

For deposit-taking corporations, the information derived from several reporting regimes available to the Central Bank was used.

Based on these general definitions, the following aspects on the values presented for the different variables should be highlighted:

- FDI Gross Position in Shares and Other Equity

  Positions were calculated using book values including, on a partial basis, adjustments in the values of assets and liabilities according to international accounting standards.

  In the event that an enterprise had omitted to report the net worth for a specific period, such net worth is estimated on the basis of the latest data of the enterprise and the change of average profitability rates for enterprises with data for both periods, by making the applicable adjustments for flows of the period reported by the enterprise (capital contributions, withdrawals, etcetera).

  The net worth value was converted to US dollars using the BCRA's Reference Exchange Rate (Communication "A" 3500) on the last business day of the period.

- FDI Gross Position for Debt with Foreign Affiliated Enterprises

  At residual nominal value. It corresponds to the stock of external liabilities with affiliated enterprises that the direct investment enterprises reported in the framework of the Survey on Issues of Debt Securities and External Liabilities of the Private Sector, implemented by the Central Bank through Communication "A" 3602, as supplemented.

- FDI Equity Income

[37] As regards financial corporations, the above-mentioned manual states that a direct investment will only consist of transactions related to permanent debt –i.e. long-term debt intended for the organization of the corporation – and to equity in shares or to fixed assets in case of branches. Thus, deposits and other assets and liabilities related to usual transactions of financial intermediaries are excluded from the direct investment.

[38] It is worth stating that the survey is mandatory only when the value of the direct investor's holdings reaches or exceeds an amount equal to US$ 500,000, and the statement is optional if holdings are below such value.

It corresponds to income accrued from regular exploitation of foreign direct investment enterprises. It is measured according to the "Operating Income Standard", which excludes all profits or losses resulting from changes in valuation, such as:

- Amortizations, depreciations and revaluations;
- Profits or losses in fixed assets (plant and equipment) deriving from the partial or total closure of a business;
- Amortization of intangible assets, including goodwill, due to unusual events;
- Amortization of research and development expenses capitalized in a previous period;
- Provisions for losses for long-term contracts;
- Profits or losses resulting from the exchange rate variation incurred by the direct investment enterprise, deriving from both business activities and from holdings of assets and liabilities in foreign currency;
- Unrealized profits or losses due to revaluation of fixed assets, investments and liabilities;
- Realized profits or losses of the enterprise as a result of the sale of assets or liabilities.

In the event that the enterprise had not reported income data for a period, it is estimated by adjusting the previous income according to the variation of average profitability rates of enterprises with data for both periods.

Estimated quarterly income was converted to US dollars using the average reference exchange rate for such quarter.

- Reinvestment of Earnings

It is calculated as the difference between the income generated by the foreign direct investment equity, estimated as stated above, and the earnings that enterprises reported to have made available to their investors –weighted by the equity of direct investors. Earnings made available and not actually paid are considered to be debt.

- FDI Debt Income

In case of debt liability income, the debt stock was calculated at the end of each period and interest was calculated to be accrued by such balances in the subsequent period, according to the interest rate accrued by each instrument.

- Net Capital Contributions and Debt Capitalizations

They result from data reported by direct investment enterprises with respect to capital contributions, capital withdrawals and debt capitalizations[39] executed during the period.

- Transfers of Shares and Other Equity

In turn, transfers of shares and other transfer of equity include purchases and sales of blocks of shares or equity of direct investment enterprises between direct investors and other investors not falling into such category. Values taken into consideration correspond to values reported by enterprises. The survey requires reporting the market value of transactions; otherwise, the proportional value of the transfer of equity relative to the enterprise's net worth is taken into consideration.

In all cases, the estimated flows were converted to US dollars at the BCRA's average Reference Exchange Rate (Communication "A" 3500) for the period when the flow occurs.

[39] Debt capitalizations do not entail new FDI inflows since they are offset by outflows for debt cancellation. However, they cause a change in the composition of the foreign direct investment enterprise's equity, by reducing liabilities and increasing its net worth.