

ARGENTINE ECONOMIC REVIEW No. 59

First half 2009

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- The world financial and monetary crisis had a negative impact on the level of domestic economic activity, triggering a 0.8% year-on-year fall in Gross Domestic Product in the second quarter of 2009. This has been the first GDP reduction since the fourth quarter of 2002. The service sector grew by 3.4%, whereas the goods sector decreased by 7.6%.
- Gross domestic fixed investment—accounting for 21% of GDP—recorded a 10.7% year-on-year reduction that responds to reduced investments in Construction, Argentine Transport material and Production equipment.
- The unemployment rate remained at one digit, reaching 8.8%, although it surpassed by 0.8 percentage points the level of the second quarter of 2008, and by 0.4 percentage points that of the first quarter of said year.
- INDEC's Consumer Price Index (CPI) accumulated a 2.5% increase during the first half of 2009, compared with the 4.6% rise in the same period of 2008, decelerating since the impact of the world crisis started to be felt on the domestic economy.
- During the first half of 2009, primary budget surplus was at ARS 7.2 billion, 65% lower than in the same period in 2008, as a result of the deceleration of income expansion and of the strong increase in government expenditure, partly due to the implementation of countercyclical measures.
- The Central Bank international reserves shrank by USD 360 million, reaching USD 46 billion by the end of the first half-year. During the same period, the exchange rate to the US dollar fell by 10% to reach ARS 3.8.
- The balance of payments current account recorded a USD 5.9 billion surplus during the first half of 2009, with a year-on-year increase of USD 3.4 billion (+135%) as a result of a USD 4.5 billion increase (85%) in trade surplus, which was notably higher than the USD 644 million (18%) rise in the deficit of the investment income account.
- During the first six months of 2009, exports totalled USD 27.3 billion—showing a 19% reduction compared with the same period in 2008—and imports reached USD 17.4 billion—a 38% reduction. As a consequence, the trade balance showed a USD 9.9 billion surplus.

1) Output

In the second quarter of 2009, Gross Domestic Product (GDP) dropped by 0.8% in relation to the same period in 2008. Thus, the series of 25 consecutive quarters of GDP growth started in the first quarter of 2003 was interrupted. On the other hand, seasonally-adjusted GDP showed a 0.3% increase compared to the first quarter of 2009. Current GDP, in annual values, totalled ARS 1.2 trillion, approximately USD 337 billion at current values.

The 7.6% reduction in the value-added in goods-producing sectors accounts for most of the GDP reduction, partly compensated for by the 3.4% increase in the value-added in service-producing sectors, which account for 54% of GDP.

The dynamics of the service sector was mainly driven by the increase in Transport, storage and communication activities (5.8% year-on-year) and of Real estate, business and renting activities

(5.2%). The contraction in goods-producing sectors followed the output fall in the three sectors with the highest GDP share: 0.9% in the Manufacturing industry, 4% in Construction, and 27.1% in Agriculture, hunting and forestry.

Regarding aggregate demand, during the second quarter of 2009, gross domestic fixed investment showed a y-o-y 10.7% fall explained by lower investment levels in Construction (-4.8%), Argentine Transport material (-27.3%) and Production equipment (-18.6%), where the domestic component fell by 4.3% and the import component by 26.7%. This backward step made the investment coefficient—namely the ratio between investment and GDP values—reach 21%, whereas in 2008 it had been at 23%. In turn, private consumption edged down by 1.8% during the second quarter of 2009 (for the first time since the second quarter of 2003), whereas public consumption rose by 6.3%.

During the first half of 2009, the industrial sectors recording the most pronounced falls in y-o-y production were basic metal industries (29% y-o-y), textile industries (13% y-o-y) and the automotive industry (12% y-o-y).

Since the last quarter of 2008, the reduction in consumption and export demand—as a consequence of the world financial and monetary crisis—had a negative impact on the automotive sector, which is a key sector in the Argentine industry. According to data from the Association of Automobile Manufacturing Plants (ADEFA), from January until August 2009, automobile production reached 291,149 units—a figure 28.4% lower than in the first eight months of 2008. Whereas overall sales to car retailers dropped 28.7%, sales of locally-produced vehicles destined for the domestic market recorded a y-o-y reduction of 24.6%. Exports plunged by 23.5% selling 175,270 units, as opposed to the 229,253 units exported between January and August 2008. It is worth noting that foreign sales absorbed 60% of the local production.

In the first six months of 2009, the sector recording the highest increase was the food and beverage industry, rising by 21% y-o-y, followed by chemicals, which recorded a 15% year-on-year increase.

2) Labour market

During the second quarter of 2009, unemployment rose to 8.8% of the Economically Active Population, increasing by 0.8 percentage points with respect to the same period in 2008. At the same time, the rate of activity (the percentage of people with a job or looking for one) remained at 45.9%, the employment rate fell from 42.2% to 41.8%, and the underemployment rate increased by two percentage points, from 8.6% in the second quarter of 2008 to 10.6% in the same period this year.

As a consequence, it can be estimated that between the second quarter of 2008 and the same period this year, 96,000 people lost their jobs (a 10% increase in the overall figure), while 5,000 jobs were created, and thus, less than 1,000,000 people are still unemployed. If the *Plan Jefas y Jefes de Hogar* (welfare payment) is excluded from the calculation, the unemployment rate reaches 9%.

The evolution has not been homogeneous throughout the different regions of the country. Out of the 31 urban agglomerations surveyed a year ago, 19 showed increasing unemployment rates. The highest unemployment rates were recorded in the following urban areas: Mar del Plata-Batán (14.4%), Ushuaia-Río Grande (11.9%), Viedma-Carmen de Patagones (11.5%) and Greater Santa Fe (11.1%). Furthermore, other three urban agglomerations—Greater Rosario, 10.8%; Bahía Blanca-Cerri 10.6%; and Salta, 10.2%—had unemployment rates over 10%; hence, there were seven urban agglomerations with two-digit unemployment figures; while during the second quarter of 2008 there were only two: Greater Santa Fe (12.6%) and Mar del Plata-Batán (10.3%).

During the first seven months of 2009, average nominal salaries rose by 9%, although there were differences between sectors. Whereas the public sector recorded a 5% increase, in the private sector, formal and informal employment rose by 9% and 13% respectively.

According to statistics published by INDEC, poverty decreased by around 4 percentage points during the first half of 2009, compared with the same period in 2008. In June 2009, 13.9% of Argentines lived in poverty, and 4% were considered to live in extreme poverty since they could not even meet their essential dietary requirements (1.1 percentage points less than in the first six months of the previous year). If the number of households is taken into account, 9.4% were poor and 3.1% extremely poor. According to INDEC, the value of the basic food basket calculated to measure extreme poverty decreased by 2% between June 2008 and June 2009, in spite of a 0.3% rise during the first half of 2009.

3) Prices

During the first half of 2009, INDEC's Consumer Price Index accumulated a 2.5% rise as opposed to the 4.6% rise in the same period of 2008, thus reflecting a deceleration of inflation. The items recording the highest increase were the following: Education (9.8%), and Transportation and communications (8.6%). In turn, some very important items for consumers like Clothing and Housing increased by 1.3% and 5.1% respectively. Food and beverages, another key item, recorded a 0.3% reduction.

During the first six months of 2009, the level of the Domestic Wholesale Price Index (IPIM) increased by 3.2% with respect to the same period in the previous year. Domestic products increased by 3.9% due to the 6.8% rise recorded by primary product prices (agricultural products rose by 4.4%) and to the 3% increase in manufactures and electricity. Imported goods fell by 4.1%. The highest increases in prices were recorded in refined oil products (14.7%), crude oil and gas (10.3%), and tobacco (9.9%).

4) Public finance

During the first six months of 2009, national public accounts yielded a primary surplus of ARS 7.2 billion, which was 65% lower than in the same period of 2008 due to a higher increase in expenses than in revenue: primary expenditure grew 29% year-on-year (ARS 30.7 billion) while income increased by 14% y-o-y (ARS 17.5 billion). After interest payment, a financial deficit of ARS 1.7 billion was recorded, whereas in the first half of 2008, there was a surplus of ARS 13.4 billion.

National tax revenue corresponding to the first half of 2009 increased by 11.3% with respect to the same period in the previous year, reaching ARS 157.3 billion. Tax resources collected by the AFIP (Federal Administration of Public Revenues)—those intended for the Public Sector—grew by 14.6% y-o-y to reach ARS 145.7 billion. The increase in revenue was driven by Social Security resources that recorded a 28.4% y-o-y rise. Value Added Tax grew by 7.1% and Income Tax by 4.7%. In turn, Customs resources fell by 7%: export duties 3.1%, and import duties 19.5%.

In late June 2009, total gross public debt was estimated at USD 140.6 billion, USD 4 billion higher than at the end of the previous quarter, as a result of the increase in public securities debt (USD 2.3 billion), mainly denominated in national currency.

5) Monetary policy

The Central Bank of Argentina (BCRA) maintained its managed floating exchange rate regime, adjusting money supply to the public's demand. While in the first quarter of this year the BCRA

purchased USD 123 million, in the second quarter it sold around USD 500 million. The level of international reserves at the end of the six-month period was over USD 46 billion. From then onwards until late August, a reduction of approximately USD 1 billion could be observed as a result of the greater demand in the foreign exchange market, mainly driven by speculation.

In the first half of 2009, the peso depreciated by 10% against the American dollar, almost 11% against the euro and 30% against the Brazilian real, reaching, by the end of June, 3.8 pesos per dollar, 5.33 pesos per euro and 1.94 pesos per Brazilian real. In July and August these three currencies continued to appreciate against the peso: on the last day of August, the dollar was worth 3.85 pesos, the euro 5.52 pesos and the real 2.05 pesos.

In June 2009, the monetary aggregate M2 encompassing currency held by the public, current accounts and savings accounts had an average ARS 175.2 billion surplus, growing by 1.2% in the first half-year (12.2% year-on-year). In turn, private M2 consolidated the recovery anticipated in May, when it was at an average ARS 145.7 billion (7.1% y-o-y).

Overall peso deposits grew by 0.5% in June. Likewise, during the same month, the broader aggregate in pesos, M3, recorded a 1.3% growth, whereas private M3 increased by 1.6%.

With the aim of instilling more dynamism in credits, the Central Bank of Argentina (BCRA) decided to carry out auctions of options to have access to repo loans in pesos. While the first auction held in June went unawarded, in the second, held in early July, the institutions bid ARS 90 million, out of which the BCRA awarded ARS 50 million. The cut-off premium was set at 1%. The awardee institutions will be able to exercise the option for access to a repo loan at a fixed interest rate of 13.4375% within the next 365 days. The amount of the repo to which they will have access shall not surpass the growth of loans recorded between the date of the auction and the time the option is exercised.

Liquidity of financial institutions did not show any significant change in June. The liquidity ratio was, on average, 22.7% of total deposits in pesos when considering the liquidity made up of cash in banks, institutions' current accounts in the BCRA and (net) repos in the BCRA. In turn, including institutions' LEBAC and NOBAC holdings, the liquidity ratio reached 36.4% of peso deposits.

Borrowing rates remained stable, while those charged on loans to the private sector showed reductions in almost all lines of credit. Particularly, the BADLAR rate¹ was at 12.9%. Regarding the most representative lending rates, that of the advances granted to companies for a sum higher than ARS 10 million with up to a 7-day agreement in the City of Buenos Aires and Greater Buenos Aires, reached an average 16%, 0.7 percentage points below the average in the previous month. Similarly, the interest rate of the most traded segment of companies' discount documents with a maturity of up to 90 days fell by 0.6 percentage points, reaching a 16.5% average, also in the City of Buenos Aires and Greater Buenos Aires. As a consequence, the spread between lending and borrowing rates continued decreasing.

In June, the evolution of credit to the private sector in pesos confirmed the recovery that it had been showing in the first months of the second quarter of the year. Compared with May, said loans increased by ARS 1.2 billion (1.1%)—a change that had not been observed since the international financial crisis deepened in October 2008, and which is basically explained by financing to the commercial segment.

6) Foreign sector

During the first half of 2009, the current account showed a USD 5.9 billion surplus, with a USD 3.4 billion (+135%) increase with respect to the same period of 2008. The financial account showed a net outflow of USD 6.2 billion as a result of net capital outflows from the non-financial private sector by USD 7.6 billion (mainly foreign asset growth) partially compensated for by a net inflow from the

¹ Monthly average interest rates paid by private banks on their wholesale deposits at up to 35 days' terms.

non-financial public sector and the BCRA by USD 1.1 billion, and the banking sector excluding the BCRA by USD 289 million.

During the first six months of 2009, Argentine foreign trade was immersed in the context of a recessive world economy. Goods exports amounted to USD 27.3 billion (-19%) as a result of a fall in prices and, to a lesser extent, in quantities. In turn, imports totalled USD 17.4 billion, plummeting by 38%, mainly due to smaller quantities. Consequently, the trade balance yielded a USD 9.9 billion surplus (+85%).

Argentine exports to all the economic regions fell, except for those to ASEAN (+46%). The greatest reductions were observed in sales to Brazil, the European Union and NAFTA, which, taken together, accounted for almost 60% of the lower overall foreign sales. MERCOSUR, the European Union, NAFTA and Chile remained as major markets, concentrating 57% of the export value.

The main origins of Argentine imports continued being Brazil, NAFTA, the European Union and China, which together represented 75% of the total and accounted for 72% of the reduction.

In sectoral terms, Primary products (-55%) were the main responsible for the negative change in exports. Their value dropped as a result of lower prices (-16%) and quantities (-28%). The 12% reduction in prices of Manufactures of Agricultural Origin (MAO) accounted for the item's fall, taking into account the 10% increase in export volumes. Regarding Manufactures of Industrial Origin (MIO), the reduction in exports was due both to a reduction in prices (-6%) and in quantities (-10%). In the case of fuels, the lower prices (-51%) more than compensated for the 52% increase in export volumes.

Most of the reduction in total imports was accounted for by imports of industrial manufactures. Likewise, the deficit reduction in industrial manufactures more than compensated for the lower surplus recorded in Primary products, MAO and Fuels, accounting for a higher surplus in the trade balance of the six-month period, in relation to the same period of 2008.

The service account deficit in the first half of 2009 was estimated at USD 387 million, USD 266 million lower than in the same period in the previous year. Inflows fell by USD 466 million mainly due to travel services; and the USD 732 million outflow reduction was accounted for by transport services. In turn, during said period, the investment income account recorded a net outflow estimated at USD 4.3 billion, out of which USD 3.1 billion corresponded to earnings and dividends, and USD 1.2 billion to interests.

7) Prospects

The world economic crisis has had considerable impact on the Argentine economy through the transmission mechanisms of foreign trade (shrinking demand of goods exports, and a fall in agricultural, mineral and fuel product prices), capital flows (reduction in foreign direct investment and foreign credit availability) and income account performance (earning, royalty and interest remittances). Argentina's growth rate in the 2003–2008 period—when GDP recorded an average annual increase of 8.5%—will turn to hardly positive or even slightly negative in 2009. According to the survey on market expectations (REM) carried out by the BCRA last August, the GDP growth rate would reach 0.5% in 2009, above the -2.5% and -1.9% respectively projected by the IMF and ECLAC for the Latin American region as a whole.

The Public administration Budget Bill estimates that by 2010 there will be a 2.5% recovery in output as a result of the economic recovery expected by late 2009, which would continue into 2010. Recent IMF and ECLAC projections on Argentina respectively forecast a GDP growth of 1.5% and 3% in 2010.

According to the macroeconomic scenario projected in the Budget Bill, the Gross Domestic Fixed Investment is expected to grow by approximately 8.2%, which means a recovery with respect to the

2009 fall (-6.2% according to REM). Private investment recovery and public works maintenance would be the most important factors that would contribute to said growth. In 2010, consumption would grow less than the rest of the demand components (2.7% according to the Budget Bill, and 2.6% according to REM), mainly as a result of the 2009 performance. Nevertheless, consumption will rise at a higher rate than GDP during 2010.

The Public Administration Budget estimates a 16.9% increase in total revenue (current and capital). The primary balance—financial balance before payment of interests—is estimated at ARS 15.5 billion for 2009 and ARS 27.2 billion for 2010, implying a 75% increase in surplus. It is worth noting that the reduction in the international prices of the main export products and the reduction in imports will lead to a fall in customs revenue, which will be compensated for by the increase in revenue from other taxes (mainly social security). It is estimated that in 2010, import and export duties will increase again (33% and 35% respectively according to the budget).

In line with the international economic scenario and domestic growth deceleration, prices have moderated their increase so far this year. The REM forecasts a 6.8% change in the 2009 consumer price index for Greater Buenos Aires (IPC-GBA); an 8% change is estimated for 2010.

Like in the last months of 2008, the American dollar continued appreciating against the peso in 2009 and in late September it reached ARS 3.84 per dollar. For 2010, the Budget projects an average exchange rate at ARS 3.95 per dollar (according to REM, at the end of fiscal year 2010 the exchange rate would be at ARS 4.62 per dollar). Regarding the monetary policy, the current financial system liquidity level, which represents 40% of all deposits, is the highest in the country's history, thus providing confidence in spite of international markets' volatility.

International prices of the main export products led to a fall in Argentine foreign sales during 2009 (-24% in the first nine months of the year). On the other hand, the impact of the world financial and economic crisis on Argentina's and particularly, Latin America's main trade partners is a crucial factor determining the future evolution of Argentine exports, especially of industrial manufactures, since the markets of the region account for two-thirds of Argentine exports of these products. According to REM, Argentina would record a 2009 fall in its exports nearing 20%. However, the trade balance will continue yielding a surplus that would be approximately 30% higher than that recorded in 2008 (USD 16.5 billion according to REM). During the first eight months of 2009, the year-on-year balance growth reached 45%.

Following the greater growth of the Argentine and the world economies, an upturn both in exports and in imports is expected for 2010. This would enable reaching an important trade surplus for the ninth consecutive year.

Nevertheless, Argentine economic performance will still depend basically on domestic demand, particularly on consumption and investment. Thus the importance of policies aimed at favouring public and private investment, since they are crucial for job preservation and creation under the current circumstances.

30 September 2009.