



The Argentine Economy during 2002 and its recent evolution (*)

The economic activity throughout 2002 suffered one of the most important falls in Argentine economic history. The GDP at constant prices dropped 10.9% (a drop similar to the one recorded in 1914 and higher than those of 1931 and 1932), and as a consequence, social indicators deteriorated considerably. Unemployment reached in May 2002 a rate of 21.5% in urban agglomerations, and the proportion of the population under the line of poverty and indigence was higher than the one during hyperinflation, in the early nineties. The GDP drop at constant prices was accompanied by an even higher drop in total consumption (-12.9%), and in particular private consumption (-14.9%). Investment and imports suffered an even bigger fall, -36.1% and -49.7%, respectively. Exports experienced a slight increase of 3.2% at constant values. It is worth mentioning that all these variations are between quarterly averages of 2002 and 2001. The crudeness of these inter-annual variations constitutes the first global expression of the depth of the crisis that Argentine population has endured.

Obviously such a crisis requires a deep analysis of its causes in order to carry out economic policies leading to reconstruction. Many papers have emphasized various roots of the crisis, and practically all of them agree on the fact that there is hardly one only cause. The Argentine crisis has different causes. The truth is that both domestic and foreign reasons conform a vicious circle characterized by the increasing need of loans, fall of pro-

duct and overvaluation of real exchange rate. These elements in turn grew due to the absence of appropriate policies attacking the problems as a whole, whereas the trap in which the economy was immersed closed and the cost of finding a way out grew exponentially.

A first analysis of seasonally adjusted series of quarterly national accounts shows that the recessive phase that began in mid 1998 reached a minimum GDP in the first quarter of 2002. The policies followed in 2000, basically aimed at the recovery of economic growth with fiscal adjustment, were unsuccessful since they underestimated the constraint already imposed by the heavy burden of the debt and the underlying exchange overvaluation. The policies carried out in 2001, within the deepening of the financial crisis, preceded the eventual abandonment of the Convertibility regime which Argentine currency had been pegged to for eleven years.

The formal traumatic abandonment of this regime was at early 2002, accompanied by the announcement of the deferral of an important number of foreign payments. The early months of the year were very uneasy and therefore it came as no surprise that the GDP in the first quarter of 2002 evidenced a negative variation of 16.3% as regards same period of the previous year, representing the most important quarterly fall in history. Thus, as from the second quarter of 1998 up to the first of 2002, the seasonally adjusted GDP accumulated a fall of over 20%. On

() This document is a summary in English language of the main subjects published in the "Informe Económico N° 44". The complete Spanish version is available at <http://www.mecon.gov.ar/peconomica/informe/indice.htm>.*

the other hand, investment continued to decrease until the third quarter of the year, accumulating, as from its peak in the second quarter of 1998, a fall of 60%. In order to have an accurate reference of the depth of the crisis it is enough to mention that the real GDP in the first quarter of 2002 registered a level similar to the first quarter of 1993.

In the second quarter of 2002, and against the forecast of local and international analysts, the economy ceased falling and even evidenced a slow recovery. A surprising aspect is the recovery of real activity, specially industrial, which started amidst the unstable monetary and financial situation of the second quarter of the year.

The liberation of the exchange rate at the beginning of 2002 was not an easy task, since it changed contractual economic relationships constituted using the previous scheme. The financial crisis, crystallized by the unanimous decision of savers of withdrawing their savings from the financial system, gave rise to a long series of banking holidays and the consequent difficulties in the chain of payments and the normal developing of real activity. The uncertain situation and the difficult instrumentation of solutions to the banking problem had as a consequence an exaggerated exchange depreciation, until the exchange rate, in April, reached almost \$ 4 per dollar. Amidst this complicated situation and the catastrophic forecasts a new economic administration took office and was soon able to stabilize the economy.

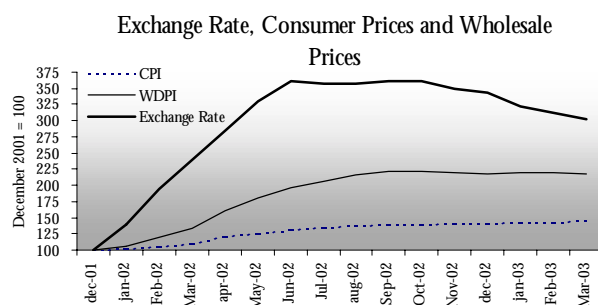
Even though there are real factors, such as the preexistent real exchange undervaluation and an important fall in the GDP in the first quarter of the year, which somehow explain the violent nominal depreciation of the peso in the first months of the year, the strong depreciation of the peso can be partly explained in

the confusing situation of the financial system. Actually the monetary aggregates have shown an important growth due to the fact that, as a consequence of the abandonment of convertibility and the break of pre-existent contracts (specially the compulsory “*pesoification*” of the exchange rate at \$ 1,40), savers tried to get rid of (within existent limitations) their assets in national currency and convert them into assets in foreign currency outside the system. The flight into US dollars was facilitated by legal sentences which protected savers and favored an immediate withdrawal of their deposits which the banks were forced to provide at the free exchange rate. In the first five months of the year currency circulation experienced a growth of about \$ 4,300 millions (+47.4%), whereas banking deposits¹, which had increased by the end of February as a consequence of “*pesoification*” at \$ 1.40 and by regulations which allowed to transfer to those accounts part of the fixed term deposits under constraints. Once overcome that effect total deposits remained stable throughout the rest of the first half of the year.

Amidst such a financial chaos, resulting from the uncertainty and the ceaseless demand for US dollars, one of the few positive aspects that can be mentioned in this period was the low translation to domestic prices (known as low “*pass-through*”). The relatively moderate domestic inflation was result of the fact that, with a strong depression and high unemployment rates the significant monetary base issue aimed at assisting financial entities (so as to allow them to meet the demand) was sterilized by the sale of international reserves of the Central Bank, which reduced up to \$ 5.5 billion from January to July. The freezing of the prices of privatized utilities and specially the non-repetition of indexation practices of the eighties (probably due to a social awareness of stability), were other reasons why depreciation did not impact strongly on prices. This is considered

¹ These deposits could be used freely by banking methods (checks and credit and debit cards) but cash withdrawals were limited.

the main reason for slowing down an economic and social situation which had threatened to get even worse.



The low pass-through of nominal depreciation to domestic prices started to outline a new structure of prices relative to goods and services of productive sectors. Contrasting the depreciations of the eighties and in spite of the turbulences, the low pass-through made it possible that even in the worst moments some fundamental relative prices were maintained. The low pass-through and subsequent change of relative prices helped not only to stop the fall of GDP, starting an important process of import substitutions, but also to stop the deep deterioration of the social situation of an important part of the population, due to the high permeability of the indicators of indigence and poverty to changes in the value of basic baskets, food and total.

As from the second quarter the level of industrial activity showed an incipient recovery which as months went by turned out to be stronger. Thus, as from then, the seasonally adjusted GDP showed for the first time since 1997 three consecutive quarters of rise, which according to preliminary indicators from the first quarter of 2003 amount to a yearly recovery of real economic activity. In fact, the seasonally adjusted GDP rose 0.8%, 0.6% and 0.8% in the second, third and fourth quarters, respectively. Even though y-o-y measurements for 2002 evidenced an

average fall of 10.9%, in the last quarter it was significantly lower (-3.6% as regards same period of 2001), and it is forecasted that in the first quarter of 2003 a positive variation above 4% y-o-y, and a growing tendency in q-o-q seasonally adjusted GDP.

It is worth mentioning that this recovery has been positively modified throughout the quarters. Thus as from the second quarter of last year two sub-periods can be noticed as regards the participation of each component in the aggregate demand of the GDP recovery.

a) A first sub-period (second and third quarters of 2002) characterized by a negative participation in the domestic absorption, because both consumption (private and public) and investment negatively influenced product growth. GDP recovery was explained by a positive participation of net exports (low growth of exports and important import substitution).

b) A second sub-period (as from the last quarter of 2002) started to evidence signs of recovery which can have characteristics of longer permanence what is deduced when it is observed that both private consumption participation and investment² have become positive in the last quarter of the year. This tendency has apparently continued during the first months of 2003 according to some provisional data. In the meantime, net exports started to negatively contribute to GDP recovery, as a result of the recovery of seasonally adjusted imports.

These changes in the composition of the GDP variation are modifying the initial skepticism on the durability of the recovery which the consolidation of these changes of tendency (and even more when speaking of steady growth) require to solve pending subjects which shall bound the policies that the new administration (elected at the end of April) shall adopt.

² Seasonally adjusted investment both in construction and in durable equipment, national and imported, show positive variation rates in this sub period.

The prices, both retail and wholesale, started to stabilize in the last quarter. The first grew an average of 0.3% monthly, whereas the second even deflated in November and December. The stability of the exchange rate due to a careful monetary policy was a main cause. In order to attain the objective of minimizing inflation without hindering the recovery of real activity, the Central Bank (BCRA) aimed at issuing monetary base according to the evolution of demand, which required consistency with the fiscal policy. As from the third quarter, for the first time in the year, the base monetary imbalances, that had meant an important financial assistance of the BCRA to financial entities and the loss of international reserves, disappeared.

As fears of inflation were dispelled and the fall of the activity stopped, the deposits³ slowly recovered and the demand for monetary base therefore increased, at first, encouraged by the recovery of banking reserves (currency circulation recovered in the last two months of the year). In this way, the excess of base supply reverted and the BCRA intervened by selling international reserves at the exchange market, and as from July the BCRA started to recover reserves while maintaining exchange stability. From July to December 2002 the BCRA acquired from the private sector a total of US\$ 2.4 billion. Even though the monthly average purchase of the period is below the US\$ 400 million, during the last three months of the year it was of almost US\$ 500 million. Even in December and throughout the first quarter of 2003 the exchange rate has dropped steadily, and at the closing of this Economic Report it was of about \$ 2.90, almost 20% less than the average of the second semester of 2002, of \$ 3.60.

A difference worth mentioning between the last quarter of year 2002 and the first months of 2003 and the previous quarters is related to the evolution of the composition of the monetary

base. In this last period, the base demand increased not only because of the increase in bank reserves but also because of currency circulation, together with an improvement of real activity, the stability of prices in the period and, due to credit constraint, a larger use of notes and coins in transactions. This last variable was falling because of the gradual elimination of constraints originally imposed in the financial system which had determined a premium on liquidity. Thus the currency circulation reached its low in September, and as from then it started to genuinely recover with the gradual restoration of the system of payments, a greater level of activity and a reduction of inflation. In this way, the excess of monetary base demand was increased and the BCRA was able to meet this demand and intervened in the exchange market, thus recovering part of the international reserves lost in the first part of the year .

Another important aspect was that LEBAC (Central Bank Notes) were placed at gradually lower interest rates and larger terms. As a reference, the Notes in pesos to 14 days were last placed in November at 4% annual. The cost of Notes to 28 days in August was at an average of 73% annual, and in November and December was reduced to averages of 8.4% and 6.8%, respectively. A slow bid for longer term documents (90, 120, 180, 270, 365 and lately to 540 days) started, always at decreasing rates. Later, in the first two months of 2003 there was a rise of interest rates (the average rate of Letes to 28 days was of 8.6%), which had more connection with uncertainty promoting factors, such as political risk facing the imminent presidential elections and the possible redolarization of deposits by the Supreme Court. Later the incidence of those reasons started to decrease and in March Letes to 28 days decreased to an average of 7.7% annual.

Another equally important aspect to be considered was that in

³ In the second semester of the year deposits in pesos grew by \$ 3,200 million (+5.8%). This tendency continued in the first quarter of 2003, with another 4.2% of growth (\$ 2,700 additional million).

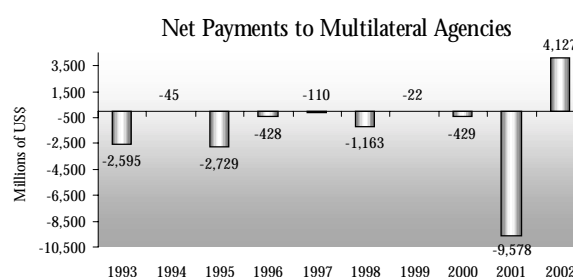
the second semester of the year the fiscal accounts steadily improved, because of a nominal better collection (in the last quarter it was over 59% compared to the same period of 2001) and the maintenance of expenditures in nominal values. Actually it is worth mentioning that the improvement in fiscal accounts started as of April, when the economic activity reached its bottom line. As from then, there has been a substantial recovery in tax collection, as a result of inflation and retentions to exports, and also of activity recovery. Tax collection in the period April-December increased 20% y-o-y (i.e. compared to same period of 2001).

Of course the primary surplus was also based in the non-increase of primary expenditure, which, as it has already been mentioned, was heavily reduced in real terms (compared to 2001 the reduction was of 28% deflated by combined prices). In fact, one of the only items in which current expenditure increased was in the program “Jefas and Jefes de Hogar” (Heads of Household Programs). The implementation of said programs made it possible to abate the effects of exchange depreciation and the consequent rise in prices (specially the basic basket) produced in the most vulnerable sectors of society. The reduction of inflation in first place and the recent recovery of real salary which accompany larger productivity and the increase of employment has started to gradually improve social indicators, specially the proportion of the population below the line of poverty and indigence.

On the other hand, foreign sector evidenced throughout the year the important adjustment suffered by the economy. The new situation fostered by the abandonment of Convertibility had significant repercussion on the balance of payments as a whole, but particularly on the merchandise account and the formation of assets abroad. In fact trade surplus was of US\$ 8.9

billion in 2002, compared to a deficit of US\$ 4,483 million in 2001, i.e. a variation of US\$ 13.4 billion. Said evolution was produced by a fall in exports⁴ much lower than the fall in imports (-5% and -56%, respectively).

It is worth mentioning that in 2002 and in the first quarter of 2003 Argentina was net payer to international institutions of about US\$ 5.1 billion, as opposed to what had happened in the previous years. In fact, from 1993 to 2001 Argentina had only been a net receiver with an annual average of US\$ 1.9 billion.



Even in this unfavorable foreign financial context, Argentina managed in the last quarters to start leaving the depressive context it was dragging since 1998, based on a careful managing of macroeconomic policy: a prudent fiscal policy and a balanced monetary policy aimed at consolidating the incipient recovery without forgetting the social objective of price stability. Therefore the Government raised the last constraints to deposits by the end of 2002 and accelerated the process of lifting the exchange constraints set up in the first months of 2002⁵.

Later, at the end of the first quarter of 2003 the National Government gave another important step to accelerate the normalization of the banking system, setting the bases to close the process of constraints to availability of deposits implemented at the end of 2001. Decree 739/2003 set forth that the bearer of

⁴ The main reason for the fall in exports was the effect of prices, since the evolution of quantities was very similar.

⁵ In the Foreign Sector Chapter appears a summary of exchange policies adopted from the end of 2001 up to date.

reprogrammed deposits up to \$ 42,000 had the option of requesting the total or partial immediate reimbursement, by the joint reimbursement of the original sum adjusted by the Reference Stabilization Coefficient (CER) at the date of fund crediting by the financial entity and of Boden 2013 in dollars by the National State for the difference between the sum adjusted at April 1st, 2003 and the exchange rate of the free dollar at that date, which was of \$ 2.9792. The bearers of deposits above \$ 42,000 and up to \$ 100,000 will be able to do so, but besides Boden 2013, the part in pesos plus CER will be credited in a fixed term deposit to 90 days with a CER adjustable capital and an interest of 2% annual. In the case of deposits higher than \$ 100,000 the part in pesos plus CER will be credited in a new fixed term deposit in the same conditions as before but at 120 days. Fixed term deposits originally constituted in pesos are totally freed, and they receive no compensation in bonds.

According to preliminary estimations, the fiscal cost of the whole operation shall be of approximately US\$ 2.7 billion should all savers involved exercise this right.

The same Decree sets forth that the banks shall have 30 working days to adhere to the cancellation scheme of rediscounts granted up to date, which might be canceled in pesos, paid off in a maximum of 70 monthly installments as from March 2004. The amount due shall bear an interest of 3.5% plus CER, and must be guaranteed by the granting of guaranteed loans with nominal value not lower than 125% of the loan capital. The entities unable to grant said guarantee might use Boden 2012 or 2013 instead.

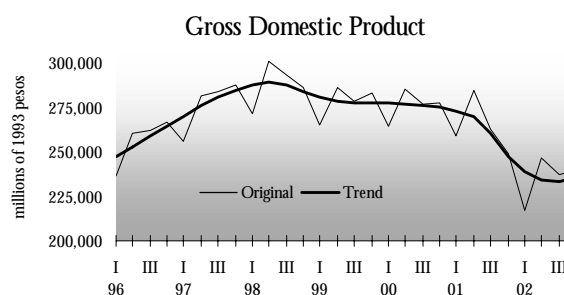
Another important step leading to the resolution of pending issues was the setting up of a process of currency unification aimed at the elimination of provincial quasi currencies. At the closing of this Report, many provinces had signed agreements

with the Nation in that respect. The final solution of the mentioned problems and the coming debt restructuring process will be fundamental steps to consolidate the recovery of the economic activity and the building of a path of steady growth, with the aim of recovering the welfare level of the population.

Next, as is customary in this Chapter, a summary of the specific chapters of the Economic Report is offered.

Economic activity

The macroeconomic evolution in the fourth quarter of 2002 determined, according to provisional estimates, a negative variation of 5.8% in global supply, measured in prices of the year 1993, compared to the same period of the previous year. This decrease was the result of a negative variation of 3.6% of the Gross Domestic Product, and 29.8% in the imports of goods and services. Regarding the global demand, there was a negative variation of 16.5% in gross domestic investment, and an increase of 6.4% in the exports of goods and services. The decrease of private consumption was 7.2%, while public consumption showed a slighter decrease (-2.1%).



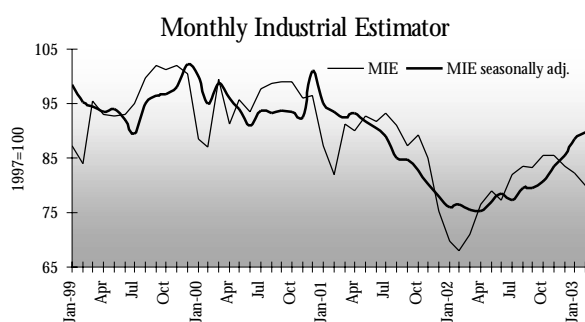
The good-producing sectors experienced in the fourth quarter of 2002 a negative variation of 1.8% determined basically by the decrease of the level of activity in agriculture, cattle, hun-

ting and forestry (-6.2%) and construction (-16.4%). Manufacturing industry registered a rise of 4.4%. The service-producing sectors registered an year-over-year decrease of 3.8%.

The provisional variation of the GDP of the fourth quarter of 2002 compared to the previous one shows an increase of 0.8%.

The values reached in the fourth quarter and the revision of the estimations of the third determined that the GDP registered a y-o-y fall of 10.9% in the year 2002 compared to the previous year. It is explained by the contracting behavior of goods-producing sectors (-11.4%) and service-producing sectors (-9.2%).

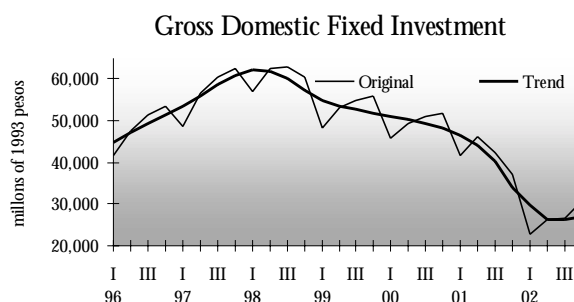
The Monthly Industrial Estimate (MIE) elaborated by INDEC experienced in January and February the third and fourth consecutive y-o-y rise. The growth was considerable (17.9% and 17.4%) but it is important to remember that they are being compared to the minimum values of the series. On the other hand, seasonally adjusted data confirms the positive tendency. The increase of 1.5% between both months constitutes the seventh positive variation. As regards groups in February there were important increases in the production of textiles (170.7%), metal-mechanic industry (121.8%), non-metallic minerals (31.3%), basic metallic (20%) and automobiles (18.9%). The only group that lowered its production was editorials and prints (-15.9%).



Investment

In the fourth quarter of 2002, the Fixed Gross Domestic Investment (FGDI) measured at constant prices continued registering minimum values, but with a fall (-16.5%) that tends to slow down. The contractions in construction (-16.6%) and investment in durable equipment (-16.2%) were slighter than in previous periods. The most important fall continued to be imported goods (-48.4%) due to the variation of respective prices (221.3%). As regards national equipment, on the opposite, there was an increase (9.2%) based in the incorporation of machinery and equipment (16.4%), since transport material continued falling (-15.4%).

The variation of seasonally adjusted FGDI compared to the previous quarter showed a significant increase (10.4%) and the softened variation was a little lower (3.6%).



Measured at current values, the investment in the fourth quarter was \$ 47.9 billion. 40.7% above same period of 2001. Even though the average of the year \$ 37.5 billion was lower than that of 2001 (-1.5%). The FGDI/GDP quotient tended to recover in the fourth quarter, after reaching minimum values in the previous ones, both at constant prices (12.9%) and nominal (14%).

Later in the same quarter, the estimations of the SICA [Synthetic Indicator of Construction Activity] were published, which

showed important y-o-y positive variations in January and February (36.9% and 38.3%) respectively). As regards sales of cement the figures from the first quarter of 2003 show an increase of 20.8%. The others supplies from which we have information have also shown significant increases last January, ranging from 15% (sales of seamless tubes) to 195.6% (tiles production).

Building permits for private buildings also reflected an increase in January (69%) and February (49.5%). Perspectives for March (supplied in the Qualitative Construction Survey) are stable. Within the private sector, 21.1% of the surveyed companies are not working in this moment and 31.9% of companies engaged in public works are idle. The Deeds of Conveyance entered in the Property Registry showed again an increase in January (37.9%).

Throughout the first quarter of 2003 sales to the domestic market of nationally produced automobiles recovered in the sector of vans and pick ups (0.1%) and trucks (4.8%) but cars continued falling (-32.2%).

Imported equipment purchases reached in the first two months of 2003 a value of US\$ 211 million, 17.6% lower than in 2002, evidencing a slowing-down of the fall and even a y-o-y increase for the month of February (19%).

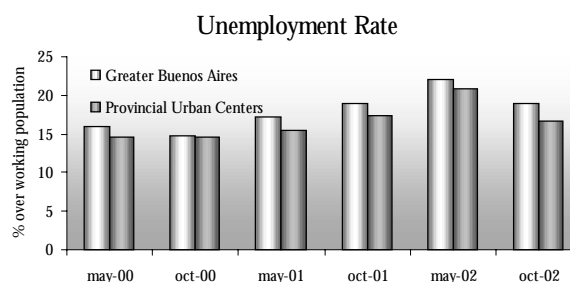
Labor Market

The data from the Permanent Household Surveys (EPH) carried out by the INDEC throughout 2002, revealed, if we consider the average of the two annual surveys an increase of the problem of employment compared to 2001. Similarly they showed the increase in the levels of indigence and poverty. The data from the Permanent Household Survey (EPH) carried out

in October 2002, in 31 urban agglomerations (previously it was carried out at 28) reveals that the average unemployment rate for the whole of the agglomerations covered by the EPH was at 17.8%, slightly lower than the 18.3% of last year October.

Open unemployment for the whole of the agglomerations covered by the EPH grew between 2001 and 2002 by 289,000 people, when considering annual averages. 86% out of this increase was in the metropolitan area of Greater Buenos Aires and the cities of the Pampa region.

The increase in unemployment is explained in similar parts by the increase of job supplies, which was increased in 149,000 people and the job loss, which showed a loss of 140,000 job positions. Greater Buenos Aires and the cities of the Pampa region are the ones that strongly participate in the increase of the PEA.



As from 2002 INDEC started to calculate a monthly Index of Salaries (IS). According to the evolution of said indicator and the Consumer Price Index, workers real salary deteriorated 19% in 2002 compared to the fourth quarter of 2001.

According to the basic information provided by the businesses' tax returns to the Integrated System of Retirements and Pensions, the monthly average of declared jobs during the fourth quarter of 2002 was of 4,308,166, amount which is 6.7%

lower than the same quarter of 2001. Average salary was of \$1,088 in the quarter, showing an increase of 9.3% as regards same quarter of the previous year. This increase results from a continuous fall in the number of jobs for lower income sectors and the increase of \$ 100 established in August in the private sector.

As an average, in 2002, the evolution of declared jobs evidences an inter annual negative variation of 9% whereas average salaries increased a 5.1% compared to the previous year.

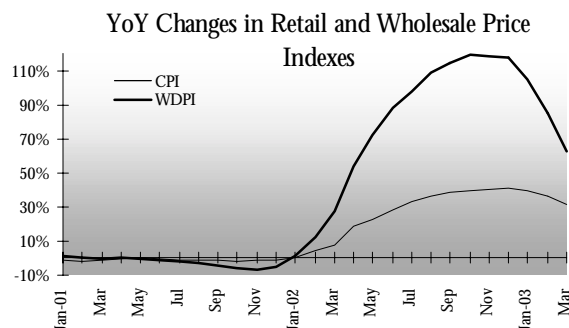
Prices

The inflation in 2002 marked the end of a decade of price stability. It was as a result of a strong change in relative prices which took place in the first half of the year, since later inflation slowed down and reached one digit as an annual percentage.

New relative prices reflected the significant modification abandoning non tradable goods in favor of tradable ones. This is one of the characteristics of the new macroeconomic context, very different from last decade since the real exchange rate (a key element for the allocation of resources and the decisions on consumption and investment) rose to more than double its average level from 1991-2001.

During the fourth quarter of 2002 nominal exchange rate stabilized at a very high historical level, basically as a consequence of a restrictive monetary and fiscal policy. Last November this indicator started to fall, making necessary the intervention of the monetary authority to avoid a deeper fall, and in the first months of 2003, this tendency to the peso revaluation increased. Internal prices responded to this change and monthly inflation rates descended rapidly, helped also by the high unemployment and the fall of real salary of early 2002. In

recent economic evolution it is noticeable the weak depreciation of the peso on the retail price index, contradicting what many analysts foresaw at the beginning of 2002.



In the fourth quarter of 2002 implied prices of GDP rose 40.8% annual. Considering quarterly averages, in said interval retail prices rose 40.3% annual and wholesale 118.5%. Thus product prices registered a variation almost identical to retail prices, due to the relative importance of non tradable sectors. On the other hand, combined prices rose 75.8% annual average in the fourth quarter, increases not recorded since 1990. Considering the rise in prices accumulated since the end of convertibility to February 2003 it is immediately perceived the lack of proportion between retail (43.6%) and wholesale (119.8%) inflation and nominal exchange (211.4%). The increase of the exchange rate almost doubles wholesale prices and triples retail ones.

As regards inflation tendency (defined as annualized quarterly inflation), in the fourth quarter of 2002 the rise of combined prices dramatically slowed down, until it almost disappeared. This was explained by the previous stabilization of nominal exchange which was stable during some months until it started to fall, ceasing the pressure on wholesale prices. As already mentioned in this Economic Report, the inflation peak registered in Argentina in mid 2002 was connected to a temporary financial crisis, derived from the previous monetary regime and did not represent a long term tendency, in an open economy where there is a high structural unemployment. On the opposite,

recent estimations foresee for 2003 a retail inflation of only 14%.

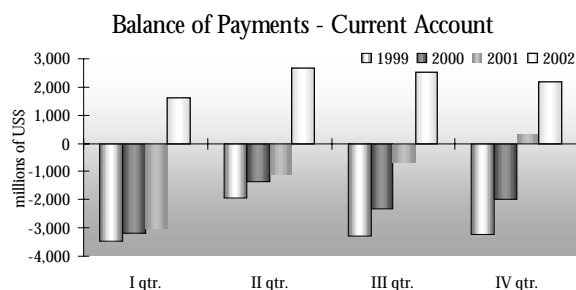
Foreign exchange improved 6.1% annual in the fourth quarter of 2002, even though this positive tendency was not enough to totally neutralize previous falls, and as a result during 2002 the average indicator fell 1.8%. There was a low in export prices higher than the reduction of import prices. But, even with low prices, at the end of the year the indicator almost reached its best historical levels. Average prices for Commodities (excluding fuels) rose in the global market 5% annual in the fourth quarter, consolidating even more in the first months of 2003. The improvement of fuels was of almost 7% up to the fourth quarter, but surpassed the 50% annual in February 2003, with the war between USA and Iraq in the foreseeable future. There were also important annual profits for grains, oils and other agricultural raw materials, the tendency for metals was much weaker.

Retail and wholesale inflation slowing down continued up to February 2003, with a calmer financial context. In February, nominal exchange type had cut the rise to 211% annual, with a recovery of 16% the peso's external purchasing value as from its minimum. It is worth mentioning that the evolution of Argentine peso during this period was better than Mexico's or Brazil's currency. In February 2003 retail prices registered an increase of 36.1% annual, wholesale 85.1% annual, and combined prices 59.2% annual. On the other hand, in 2002 real exchange rate surpassed with excess its levels in the 11 years of convertibility period and even the levels of the 80's. Notwithstanding its fall of 22% from June 2002 to February 2003 was very significant, an effect known in economic literature as overshooting. It is necessary to mention that the years of convertibility had been characterized by an extremely low exchange rate in historical terms (which eventually became unsustainable), but symmetrically, depreciation of the peso had taken the fo-

reign currency to levels too high for the Argentine experience leading to the atypical first six months of 2002 which later started to revert.

External Sector

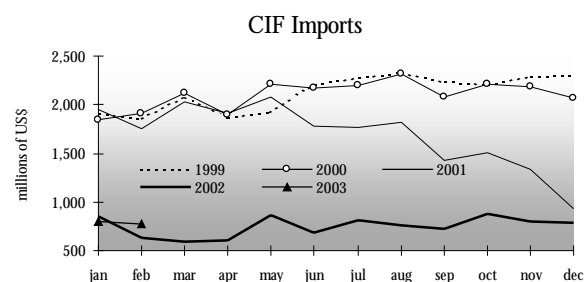
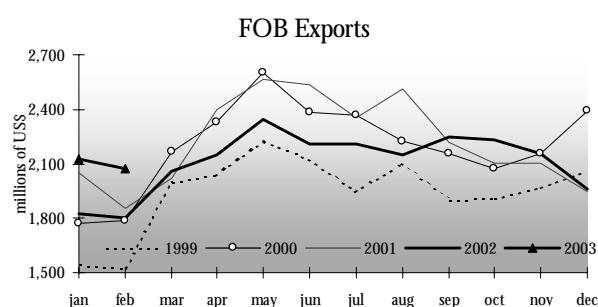
During the fourth quarter of 2002 the current account balance of payments registered a surplus of US\$ 2.16 billion, while, the financial account registered a net outflow of US\$ 1.27 billion and international reserves increased in US\$ 1.07 billion. Throughout this period was accelerated the slowing down of capital flight started in the previous quarter and exchange rate kept a slightly decreasing tendency. The increase of international reserves of the BCRA was the first since the fourth quarter of 2000, when funds came from the financial armour ("blindaje").



In the year 2002, the surplus of the current account amounted to US\$ 8.95 billion compared to a deficit of US\$ 4.48 billion in 2001, i.e. a variation of US\$ 13.44 billion. It is worth mentioning that the current account registers accrued flows therefore the balance from 2002 includes US\$ 4.3 billion of deferrals in the payment of interests. As from a wider perspective, the adjustment of the foreign sector had started in 1998, when the current account registered a deficit of US\$ 14.53 billion. The surplus of the year is explained by the enormous surplus of the goods account of US\$ 16.88 billion (US\$ 7.45 billion

in 2001) derived from the fall in imports and by the lower net outflows of services and the reversion of the utilities and dividends balance.

In 2002 the value of good exports reached US\$ 25.4 billion, a diminution of 5% compared to the previous year and caused mainly by the drop of export prices. F.O.B. exports totaled US\$ 8.47 billion, 56% less than in 2001, due to the joint effect of peso devaluation and economic recession. As a consequence, the trade balance was of a surplus of US\$ 16.9 billion, US\$ 9.4 billion more than the previous year and a historical record for Argentina.



The balance of the financial account in the quarter was of US\$ 1.3 billion. The Private sector recorded a net outflow of US\$ 1.7 billion, the banking sector of US\$ 183 million, and the non-financial public sector and BCRA had a positive balance of US\$ 630 million.

On the other hand, the balance of the finance account registered in the year a net outflow estimated in US\$ 11.5 million,

which is disaggregated in a net outflow of non financial private sector of US\$ 12.1 billion, net outflows and BCRA of US\$ 877 million.

The difference between the first and the second half of the year is outstanding as regards financial flow and international reserves. The finance account registered in the first semester net outflows of US\$ 8.0 billion, which were reduced to less than half in the second (US\$ 3.5 billion), whereas international reserves of the BCRA fell by US\$ 5.3 billion in the first semester and increased in US\$ 846 million in the second.

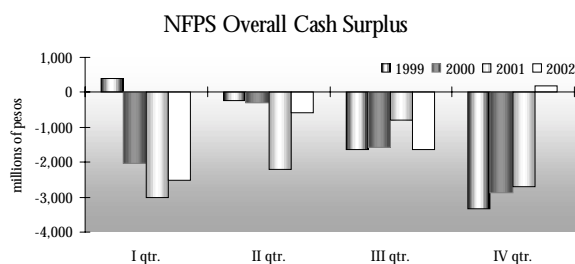
In the fourth quarter there were net inflows by Direct Foreign Investment (DFI) of the non financial private sector of US\$ 783 million, the highest since the second quarter of year 2001.

Public Finance

In 2002 the global result of the non Financial National Public Sector (SPNNF) cash based registered a deficit of \$ 4.5 billion. As regards 2001 the deficit shows an important fall of \$ 4.2 billion, mainly due to an increase in income over a slight fall in expenditure.

The primary surplus (i.e. excluding the payment of public debt interests) minus privatizations resources is in \$ 860.6 million above the one registered in 2001, mainly due to the growth of current income as a consequence of higher tax income favored by the profit in foreign trade taxes.

As regards the dynamics of the public accounts performance in 2002 an important difference can be noticed between the first and second semester. The first was characterized by a fall in current income, together with a strong cut in the services of the Public Debt, whereas in the second semester an important increase in tax income was observed, as well as a significant slo-



wing down of the fall of herein above mentioned payments. Besides this dynamic were the Transferences to the Private Sector and income generated by Property Tax, with a steady increase as from the second quarter of the year.

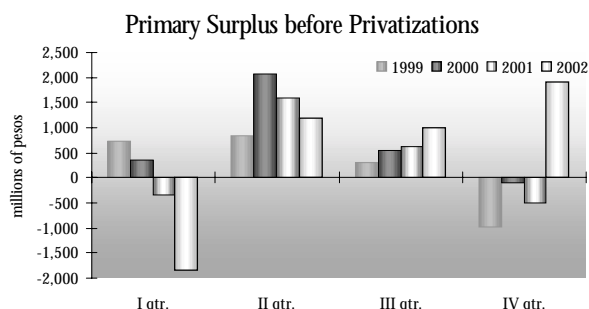
Current income increased 9%, reaching an amount of \$ 55.7 billion which turned out as \$ 4.6 billion superior to the one registered in 2001. This difference is mainly explained by the behavior of tax resources followed to a lesser extent by the property tax and non tax income. The first grew in \$ 2.9 billion (7.7%). This rise, which represents about 62.4% of the increase of current income of the year had as a consequence a higher collection in the item of export taxes. It is also important to mention the increases in IVA (VAT) payment, Banking Credits and Debits and in taxes on Fuels and Gas.

As regards Total Expenditures, in 2002 there was an increase of \$ 335.7 million as a consequence of the increase in Transfers to Private Sector (\$ 2,876.6 millions in the already mentioned social plans, and also subsidies to vial and transport licensees), to Public Sector (\$ 788.9 million), in Consume and Operation expenditures (\$ 595.9 million) and foreign debt interest (\$ 908.6 million). As a whole, all this rises imposed on the cuts to Foreign Debt Interest (-\$ 4,273.7 million) and Capital Expenditures (-\$ 461.8 million). If we observe the dynamics of the main contribution to the expenditure reduction, Foreign Debt Interests, we notice a great fall in the first semester of the year because of the default declared at the beginning of the year.

With respect to Total Expenses, in the year 2002 there was an

increase of \$ 335.7 million, as a result of the increases in Transfers to the Private Sector (\$ 2.9 billion to Social Plans already mentioned, to which were added subsidies to highway and transport concessionaries), to the Public Sector (\$ 788.9 million), Consuming and Operation Expenses (\$ 595.9 million) and Interests on Foreign Debt (\$ 908.6 million). As a whole, all these increases were imposed on the cuts to the Interests on Foreign Debt (-\$ 4.3 billion) and to Capital Expenses (-\$ 461.8 million). If the evolution of the main contributor to the decrease in expenses, the Interests on Foreign Debt, is observed, there appears a great fall in the first semester of the year owing to the default declared at the beginning of 2002. In contrast, on the third quarter there is a rise as a result of the Services operated with the IMF and the BIRF and the covering of the interests corresponding to the BODEN and Par Bonds in September. That rise was later compensated by a similar fall in the last quarter (-\$ 805 million).

Thus, Primary Expenses (which exclude payment of interests on Public Debt) increased by \$ 3.7 billion (7,4%) respect to 2001, breaking the tendency of the last few years. It is important at this point to mention that, given that prices rose 80% combining both wholesale and consumer segments, in calculating the evolution in real terms there appears a 39% fall, showing the considerable efforts of the Government to preserve Public Expenses from the effects of inflation. A similar analysis corresponds to Total Income, which after discounting the effect of inflation fell by 38%.



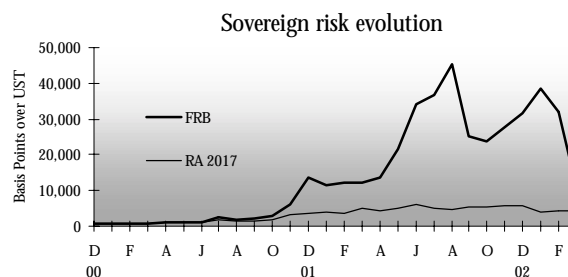
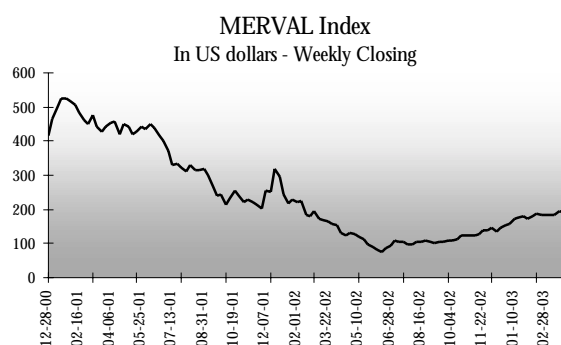
Capital Markets

In the second half of 2002, the effects of the financial and economic crises of 2001 began to be overcome. After the more acute effects of the crisis originated in the downfall of the convertibility system were surpassed, in the second semester of 2002 the prices of financial assets began a slow recovery with respect to the low values that were reached towards mid-year.

The price of shares measured by the Merval indicator (expressed in US dollars) rose from 92 average points in June 2002 to 156 points in December, a relative increase given the fall accumulated after the devaluation of the Peso. Nevertheless, the improvement extended to the whole panel of leading businesses, both Export and those that sell primarily to the local market, and even to Banks, because deposits began to grow as from August. Later on, the rise continued, with Merval approaching 200 points in March 2003.

On the contrary, in the fourth quarter of 2002 and the first of 2003 the main Public Bonds issued before 2001 (Brady and Global Bonds) remained at low levels, since their payment was still deferred. The implicit sovereign risk in their prices remained at over 6000 basis points, though in the weeks immediately after the closing of this report it showed a clear tendency to fall given the sudden appearance of buyers.

Financial constraints at the beginning of the year originated a complex program of reprogramming of deposits, utilizing bank certifi-



ates (CEDRO) or state bonds (BODEN). In September 2002 the second phase of the exchange of bonds for deposits was implemented with BODEN 2013, with additional guarantees from the banks involved, or with 10-year bank notes in pesos, with additional guarantee from the State for the difference with the US dollar. At the same time long term bonds were issued to compensate the banks for the asymmetries in the conversions of assets and liabilities in US dollars to pesos. The total value of BODEN issued thus surpassed US\$ 14 billion. Recently it was announced that the liberation of the remaining immobilized deposits will take place soon at a value of \$ 1.40 plus the CER coefficient in cash, with the State covering the difference with the price of the dollar with a 10-year bond. This last option would then result in the most convenient with regards to the two previous ones.

The difficult negotiation with the international credit organizations to refinance the maturity of public debt was finally closed in January 2003. Nevertheless, during 2002 the country had to make efforts to make net payments of over US\$ 4.1 billion to those organizations, even though other payments were deferred. Those payments were in contrast to what seems to have been the norm in the last decade, when Argentina was a net recipient of funds from those organizations.

The external sector was characterized by signs of recession in the economy of the developed countries, in particular in the US, a context that was worsened by the political crisis unleashed by the war in Iraq. Towards February 2003 the American stock exchanges

still remained at low values, following a short recovery the past November. The US Federal Reserve decided in November 2002 to lower the short term (yearly) interest rate to 1.25%, a low value for the last few decades. The US Stock Exchange thus closed in 2002 its third consecutive bear year, which had not occurred since WW II. Finally, the income tax cut and the raise in military spending, besides the war with Iraq, partially stopped investments and made for a strong reappearance of the problem of the fiscal deficit.

In Latin America, the beginning of the solution of the Argentine crisis and the successful political transition in Brazil produced a fall in financial volatility in the region.

In Europe, economic activity decelerated during 2002, but the Euro tended to rise given the relative weakness of the US, particularly during 2003, while Japan continued to suffer the effects of its own financial crisis and high level of public debt. At the close of this chapter the IMF forecasts show the possibility of a worldwide recession in 2003 if, as a consequence of a range of factors (war in Iraq, rise in oil prices and depreciation of the US dollar) there is a fall in consumption and investment in the US.

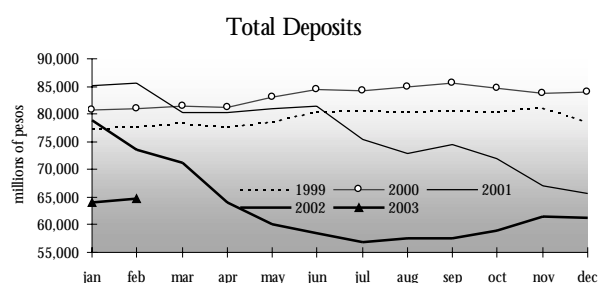
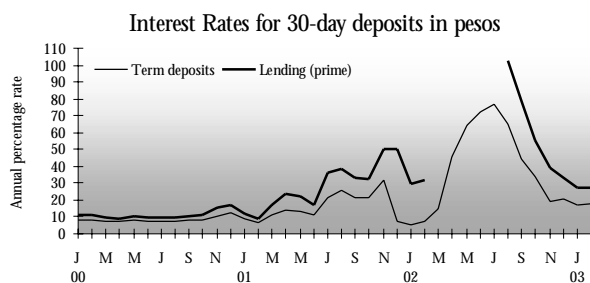
Money and banking

Up to June 2002 the monetary panorama showed a strongly negative tendency, and it was then when the monetary variables started to stabilize and by the end of the year the situation was encouraging. Between January and June there

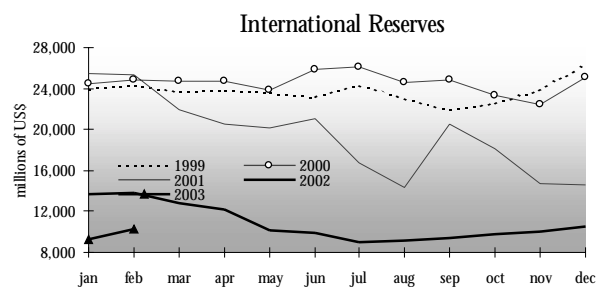
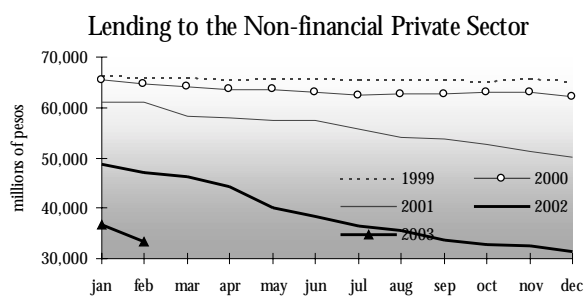
was a dramatic fall of deposits of the private sector, that made the Central Bank (BCRA) increase monetary issue to aid financial entities, generating an excess of supply in the monetary market. But a prudent management of the monetary policy made it possible during the second semester to correct the main distortions produced at the beginning of year 2002.

In July the “dripping” of deposits stopped and, for the first time in the year, there was an increase in the demand of pesos. International reserves grew caused by net purchases by the BCRA to the private sector, while the rate of exchange lowered to end the year at around \$ 3.30, after a peak of almost \$ 4 in May and an average of \$ 3.60 for the year. The increase in the stock of deposits improved the liquidity of the banks, the aid of the Central Bank to financial entities was reduced and interest rates lowered. But the increase of funds in the banks did not encourage granting new credits. Loans to non financial private sector in pesos at the end of December reached \$ 28.5 billion and in dollars US\$ 2.9 billion. If the later were “pesoified” at an exchange rate of \$ 1 per dollar, the total of loans to non financial private sector would have fallen 40% in the year. Notwithstanding this fact, the monthly fall slowed down as from October.

At the beginning of 2003 the positive evolution consolidated. In January an agreement with the IMF was entered which established the granting of a “stand by” credit to cover the obligations with the international entity until August 2003



THE ARGENTINE ECONOMY DURING 2002



and refinance those obligations with programmed payments but not demandable. The monetary objectives the Argentine

government had agreed to were “over achieved” in the first period of the agreement.

Selected Macroeconomic Indicators

I. Quarterly and Annual Indicators

	Source	Unit	I-02	II-02	III-02	IV-02	1998	1999	2000	2001	2002
National Accounts											
GDP	(1)	YoY % Chg.	-16.3	-13.5	-9.8	-3.6	3.9	-3.4	-0.8	-4.4	-10.9
Goods	(1)	YoY % Chg.	-19.4	-13.4	-10.2	-1.8	4.2	-5.2	-3.1	-5.2	-11.4
Services	(1)	YoY % Chg.	-13.3	-11.6	-8.0	-3.8	4.7	-1.6	0.5	-4.0	-9.2
Private Consumption	(1)	YoY % Chg.	-18.8	-17.2	-13.8	-7.2	3.5	-2.0	-0.7	-5.7	-14.4
Public Consumption	(1)	YoY % Chg.	-7.5	-4.2	-6.8	-2.1	3.4	2.6	0.6	-2.1	-5.1
GDFI	(1)	YoY % Chg.	-45.4	-43.0	-37.5	-16.5	6.5	-12.6	-6.8	-15.7	-36.1
Construction	(1)	YoY % Chg.	-40.1	-38.3	-32.2	-16.6	5.8	-10.8	-5.3	-9.4	-32.2
Locally-manufactured Machinery and Equip.	(1)	YoY % Chg.	-32.3	-21.1	-18.8	9.2	2.2	-11.3	-10.5	-22.1	-16.1
Imported Machinery and Equipment	(1)	YoY % Chg.	-72.6	-76.6	-70.8	-48.4	12.5	-18.2	-7.5	-27.6	-69.1
Exports of Goods and Real Services	(1)	YoY % Chg.	5.6	-1.6	3.4	6.4	10.6	-1.3	2.7	2.7	3.2
Imports of Goods and Real Services	(1)	YoY % Chg.	-57.4	-56.0	-49.5	-29.8	8.4	-11.3	-0.2	-13.9	-49.7
External Sector											
Balance of Payments	(2)										
Current Account	(2)	in millions of US\$	1,589	2,682	2,520	2,163	-14,530	-11,900	-8,807	-4,444	8,954
Merchandise	(2)	in millions of US\$	3,736	4,670	4,450	4,027	-3,097	-795	2,558	7,451	16,883
Real Services	(2)	in millions of US\$	-549	-386	-320	-248	-4,433	-4,106	-4,288	-3,908	-1,503
Financial Services	(2)	in millions of US\$	-1,664	-1,688	-1,694	-1,776	-7,406	-7,397	-7,372	-8,213	-6,822
Unilateral Transfers	(2)	in millions of US\$	67	85	84	160	406	398	294	227	395
Changes in International Reserves	(2)	in millions of US\$	-2,187	-3,128	-215	1,014	3,438	1,201	-439	-12,083	-4,516
Exports of goods (FOB)	(3)	in millions of US\$	5,684	6,702	6,612	6,349	26,441	23,326	26,410	26,655	25,347
Imports of goods (CIF)	(3)	in millions of US\$	2,072	2,160	2,294	2,462	31,404	25,508	25,243	20,312	8,988
Trade balance	(3)	in millions of US\$	3,612	4,542	4,318	3,887	-4,963	-2,182	1,167	6,343	16,359
Export price index	(3)	% Chg. in period	-3.0	-1.0	4.3	3.9	-10.4	-11.2	10.0	-3.4	-4.5
Import price index	(3)	% Chg. in period	6.0	-5.9	0.2	-1.8	-5.1	-5.6	0.0	-2.9	-2.8
Terms of trade index	(3)	% Chg. in period	-8.4	5.3	4.2	6.0	-5.5	-5.9	10.0	-0.5	-1.8
Public Finance											
NFPS overall surplus (incl. privatizations)	(4)	in millions of \$	-2,518	-581	-1,636	186	-4,074	-4,768	-6,792	-8,719	-4,549
Total tax revenue	(4)	in millions of \$	9,489	12,326	14,062	14,599	50,042	47,643	49,102	45,430	50,476
Public debt	(4)	in millions of \$	112,616	114,754	129,794		112,357	121,877	128,018	144,453	
Money											
Bimonetary deposits	(5)	in millions of \$	71,218	58,577	57,587	61,200	76,794	78,662	83,913	65,601	61,200
Bimonetary M3	(5)	in millions of \$	83,418	71,610	70,484	77,576	90,290	92,383	96,469	74,692	77,576
Interest rates											
30-day deposits in \$	(5)	%	15.05	72.17	44.46	20.72	8.1	10.3	12.3	7.4	20.7
30-day prime loans in \$	(5)	%	n.d.	n.d.	78.83	33.48	10.80	13.5	16.9	s.d.	33.50
Capital Market											
Merval (in US\$)	(6)	YoY % Chg.	-46.7	-41.5	16.8	44.4	-37.6	28.4	-26.7	-29.3	-47.4
Burcap (in US\$)	(6)	YoY % Chg.	-32.6	-25.7	2.6	10.8	-22.8	26.9	-27.7	10.3	-43.0
Discount strip	(6)	Basis points (*)	4,192	4,430	9,226	5,821	1,010	767	1,066	3,906	5,821
FRB	(6)	Basis points (*)	12,276	34,020	25,090	31,628	730	589	681	13,615	31,628

(*) Spread on US Treasury Bonds, month-end data

Sources: (1) National Bureau of National Accounts - INDEC [National Institute of Statistics and Census]

(2) National Bureau of International Accounts - INDEC [National Institute of Statistics and Census]

(3) INDEC [National Institute of Statistics and Census]

(4) Secretariat of the Treasury - Ministry of Economy

(5) BCRA [Central Bank of the Argentine Republic]

(6) National Bureau of Credit Information and Negotiation - Ministry of Economy

THE ARGENTINE ECONOMY DURING 2002

Selected Macroeconomic Indicators

II. Monthly Indicators

	Source	Unit	Jul-02	aug-02	Sep-02	Oct-02	Nov-02	dec-02	jan-03	Feb-03
Activity										
Monthly Industrial Estimator	(3)	Var.% 1 month (s.a.)	-1.4	2.7	0.3	1.4	3.3	2.6	3.4	1.5
		Var.% 12 months	-12.2	-8.5	-4.6	-4.2	0.6	10.7	17.9	17.5
Investment										
Cement shipments	(7)	Var.% 12 months	-30.3	-22.0	-18.1	-11.7	-22.2	4.0	21.4	23.1
Import of capital goods CIF	(3)	Var.% 1 month	20.8	24.1	-12.0	69.5	-34.2	13.2	-19.9	19.8
	(3)	Var.% 12 months	-74.6	-71.8	-67.4	-44.6	-54.5	-45.6	-39.8	19.0
Labor market										
Activity rate	(3)	%	-	-	-	42.9	-	-	-	-
Employment rate	(3)	%	-	-	-	35.3	-	-	-	-
Unemployment rate	(3)	%	-	-	-	17.8	-	-	-	-
Prices										
CPI	(3)	Var.% 1 month	3.2	2.3	1.3	0.2	0.5	0.2	1.3	0.6
WDPI	(3)	Var.% 1 month	4.6	5.0	2.4	0.5	-1.7	-0.4	0.4	0.4
WBDPI	(3)	Var.% 1 month	4.7	5.0	2.6	0.5	-1.0	0.5	0.1	-0.3
PBPI	(3)	Var.% 1 month	5.4	5.1	2.8	0.4	-0.7	0.4	0.1	-0.2
CCI	(3)	Var.% 1 month	3.9	1.6	1.5	0.7	0.5	-0.3	1.0	-0.1
Public Finance										
Revenues from DGI, ANA and SSS	(4)	\$ millions	4,987	4,731	4,344	4,764	5,021	4,814	5,601	4,654
VAT	(4)	\$ millions	1,413	1,364	1,340	1,424	1,502	1,314	1,686	1,354
Income tax	(4)	\$ millions	764	844	683	849	1,111	938	1,095	803
Social security revenues	(4)	\$ millions	915	702	680	741	687	693	1,006	713
Foreign trade	(4)	\$ millions	865	812	609	745	769	653	815	743
External sector										
Exports of goods (FOB)	(3)	US\$ millions	2,211	2,151	2,251	2,229	2,160	1,960	2,131	2,072
Imports of goods (CIF)	(3)	US\$ millions	813	764	717	874	807	782	798	777
Balance of trade in goods	(3)	US\$ millions	1,398	1,387	1,534	1,355	1,353	1,179	1,333	1,295
Liquid BCRA reserves	(5)	US\$ millions	8,986	9,102	9,404	9,787	10,022	10,485	9,326	10,226
Nominal exchange rate	(5)	\$/US\$	3.68	3.62	3.73	3.53	3.57	3.36	3.24	3.2
Money										
Bimonetary deposits (#)	(5)	\$ millions	56,927	57,612	57,587	58,899	61,510	61,200	64,105	64,771
Bimonetary M3 (#)	(5)	\$ millions	70,375	70,878	70,484	71,959	75,279	77,576	80,397	81,359
Rates of interest										
Deposits in \$ at 30 days	(5)	%	76.70	65.05	44.46	34.13	19.01	20.72	17.03	17.55
Prime loans in \$ at 30 days	(5)	%	-	102.38	78.83	55.24	39.41	33.48	27.49	27.43
Capital market										
Merval	(6)	% chg. in period	4.7	7.4	3.9	14.1	12.4	12.6	10.5	8.2
Burcap	(6)	% chg. in period	0.2	3.8	-1.3	-0.2	9.9	0.9	12.4	0.9
Discount strip	(6)	Basis points (*)	5,284	7,748	9,226	4,434	3,779	5,821	5,239	4,260
FRB	(6)	Basis points (*)	36,603	45,328	25,090	23,713	27,804	31,628	38,462	31,836

(*) Spread on US Treasury bonds - month-end data.

(#) Since January 2002 the rules and regulations of the exchange rate arrangement disposed of by Law Number 25,561 stated the report \$ 1,40 = US\$ 1

Thus and in accordance with Decree Number 214/02 about rearrangement of the financial system, since January 2002 all deposits are presented as the sum of the deposits in pesos and of those in dollars converted

into pesos according to the relation \$1,40=US\$1. Same method was used in the case of M3* aggregate. Since January 2003 the Central Bank restablishes the reporting of bimonetary aggregates in a single currency

(pesos); to obtain these figures, the amount in US dollars is converted into pesos by using the reference exchange rate.

Sources: (1) National Bureau of National Accounts

(2) National Bureau of International Accounts

(3) INDEC [National Institute of Statistics and Census]

(4) Secretariat of the Treasury

(5) Central Bank of the Republic of Argentina

(6) National Bureau of Credit Information and Negotiation

(7) Association of Portland Cement Manufactures