

Highlights of Argentina

A wrap-up of 2007
and a forecast for 2008*



*connectedthinking

PRICEWATERHOUSECOOPERS 

1. Overall Context

The Argentine economy saw its fifth consecutive year of growth since the crisis in 2001. This achievement is reflected in all areas of aggregated demand, but the fundamental driver of the growth of the economy was private consumption.

Once again, the increase of the GDP had its correlation in a decrease in both unemployment and poverty and a greater utilization of installed capacity. Therefore, domestically, the Argentine economy is in a position of a very high utilization of its productive resources, which should next year spur larger investments in capital assets.

Public accounts continued with a primary and financial surplus, both, backed up in large part by an increase in tax collection on exports and in the reform of the social security system. The 2008 Budget Project expects a primary surplus of 3.15% of the GDP.

The foreign sector achieved both a commercial as well as a financial surplus. It should be noted that due to economic growth the value of imports increased on a larger scale than those related to exports, despite the increase seen in the prices of the main products that Argentina exports.

Thus the Argentine economy is consolidating its growth. Still, it will have to take into account pending tariffs and energy reforms and promote new investments in the country if it wishes this growth to remain sustainable over the long term.

2. Economic Indicators

GDP

In 2007, the Argentine economy developed a GDP growth of 8.7 % at constant prices, with an accumulative 5 years of growth.

This trend continues to sustain itself in private consumption, which in 2007 represented 65.5% of the GDP and accumulated an annual growth rate of 9%.

For the other demand components positive variations were also observed in gross fixed domestic investment (14.4%), in public consumption (7.4%) and in exports of assets and real services (8.9%). Nonetheless, it's worth mentioning that during the last year, Argentina experienced a greater bias toward consumption and services and that investment experienced a deceleration in comparison to 2006. This deceleration of approximately 4 percentage points in the investment growth rate is explained by a drop in the construction sector; while the other component of investment, durable goods, experienced an increase on the order of 7 percentage points in comparison to last year.

Balance of payments and trade balance

The surplus of the balance of trade was US\$ 10.9 billion in the last year. Exports reached a value of US\$ 55.6 billion and imports US\$ 44.7 billion. While the former grew by 19.8% in comparison to last year, the latter saw a 30.9% increase, which translated into a drop of 11% of the balance of trade surplus in respect to 2006.

The increase of the value of exports is explained by a 12% increase in the prices of exported products and the remaining 8% by an increase in volume. As for last year, there was an increase in all categories, excluding Fuel and Energy. Relative to the structure of Argentine exports, the agriculture and industrial manufacturers were the two areas with the strongest results, 35% for the former and 31% for the latter.

The increase in imports is mainly a product of the growth of imported products related to the automobile industry, cellular telephone devices, fuel and electrical energy, among others. As will be mentioned in the section on Industrial Activity, the automobile sector was one of the industrial sectors that showed important growth.

The drop in exports in the category of Fuel and Energy, explained in its entirety by a decrease in export volume in an international context of fuel price increments, as well as the increase of imports within this category, has its correlation in the energy crisis affecting Argentina.

Differently from 2006, in which a deficit in the capital account of the balance of payments was seen due to the pay off of IMF debt, in 2007 the financial account registered net earnings of US\$ 5.5 billion.

International Reserves grew 44% compared to the previous year, reaching US\$ 46 billion at December 2007.

Public and external debt

The total external debt at the end of September 2007 was estimated at US\$ 118 billion which is US\$ 137 million less than at the end of last June. This decrease basically was caused by a US\$ 300 million drop in public sector external debt.

Public debt in December 2007 reached US\$ 145 billion, including a pending debt with the Paris Club but excluding the US\$ 28 billion of those creditors (Hold-Outs) who refused the 2005 debt swap.

In 2008, on-going negotiations with the Paris Club will continue to renegotiate the nearly US\$ 6 billion dollars left unpaid since the 2001 crisis. This situation represents a restriction to financial access for those investors from countries that are members of this institution: European countries, Japan and the United States. At the same time, this restriction implicated the financing of 1.75 billion dollars from the government of Venezuela, at an interest rate greater than what could have been obtained through the Paris Club.

Industrial Activity

Industry increased at a lower level than in past years and was propelled by a 25.4% growth in the automobile sector. Construction dropped importantly.

The continuous increase of industrial activity is, in a context in which investments would seem to be insufficient to meet a demand in constant growth, concurrent with a high utilization of installed capacity. In the fourth quarter of 2007, this number reached 77.2% which represents an approximate rise of three percentage points compared to the same period last year.

The energy crisis is a risk issue that could limit industrial growth.

Unemployment and Poverty

Up to the fourth quarter of 2007, the unemployment rate dropped approximately 1.2 percentage points to 7.5%, if one includes those who are recipients of the "Plan Jefas y Jefes de Hogar" (Household Heads) as employed; if however one excludes the beneficiaries of these plans, the unemployment rate goes up to 8.1% of the economically active population.

The population under the poverty line dropped to 23.4% in the second half of 2007.

Inflation and exchange rate

The Consumer Price Index has experienced a growth of 8.5% in 2007, propelled by an important increase in the prices of food, transport, communications as well as in health and educational costs. Nonetheless, the methodology and the procedures of measurements used by the INDEC, the National Institute of Statistics and Census, are being questioned and have given rise to parallel estimations of the inflation level, done by economic consultants from the private sector. These estimations vary between 16% and 22%. Salaries, on the other hand, have experienced an interannual increase of 22.7%.

The Internal Wholesale Price Index, for its part, experienced a 14.6% growth, which represents a 7.4 rise in percentage points in respect to the previous year.

The exchange rate has remained stable at an annual rate of US\$ 3.11 as a consequence of an active financial policy carried out by the BCRA.

Interest rate

As to the financial market, the principal rates remained relatively stable in the last two months of 2007, in spite of unrest seen in the international financial markets.

The passive interest rate for deposits in pesos rose from 7.86% in December 2006 to 11.20% in December 2007. Nonetheless, as from the abandonment of the convertibility system, they have remained negative in real terms. For its part, the active rate for top line companies reached a 15.99% level at December 2007.

Fiscal Account

In 2007, the primary fiscal surplus reached 25.7 billion pesos, the equivalent of 3.2% of the GDP, achieving a fifth consecutive year of primary surplus.

Given the acceleration of growth in public spending, the positive result (similar to that observed in 2006) has its correlation in diverse measures that went into effect in 2007.

In first place, the increase in tax rates on exports, put into effect in November 2007, signified increases varying between 5 and 10 percentage points in the level of tax rates for exports of the four principal crops in Argentina (soy, corn, wheat and sunflowers) and their sub products, and a new mobile withholding scheme for the exportation of oil and its derivatives.

In second place, reform of the Social Security System opened the option for contributors to transfer from the capitalization system to the government's pay-as-you-go system and for those undecided there was an automatic transfer to the pay-as-you-go system, implicating a short-term increase of tax collection by the State.

For its part, the financial surplus has seen positive results since June 2003, with November 2007 showing a 1.5% increase of GDP.

3. Tax

Decree 298/2007 (published in the Official Gazette on 3/29/2007) Income tax - Personal deductions - Increase in the non-taxed minimum amount - Dependants and special deduction - Article 23 and the article added after article 23 of the Income Tax Law have been amended increasing the annual deduction amount in respect to non-taxed income, dependants and the special deduction, computable for determining the tax corresponding to individuals and undivided estates.



New amounts:

- Non-taxable income up to \$ 7,500 (\$ 6,000);
- For dependants in the case that the annual net income is not in excess of \$ 7,500 (\$ 6,000):
 - Spouse: \$ 6,000 (\$ 4,800) per annum;
 - Son, daughter, stepson or stepdaughter under 24 or incapacitated for work: \$ 3,000 (\$ 2,400) per annum;
 - \$ 3,000 (\$ 2,400) per annum per each direct-line descendant (grandson, granddaughter, great-grandson or great-granddaughter) under 24 or incapacitated for work; per each ancestor (father, mother, grandfather, grandmother, great-grandfather, great-grandmother, stepfather and stepmother); per each brother or sister under 24 or incapacitated for work; father-in-law, mother-in-law; per each son-in-law or daughter-in-law under 24 or incapacitated for work;
- Special deductions up to \$ 7,500 (\$6,000) in the case of net income under Article 49, whenever one works in an activity or a company which generates net income as included in Article 79.

The scale for the increasing reduction of deductions in the article (without number) following Article 23 has gone from \$ 45,500 to \$ 48,000 in the first and second periods.

Effective date: 3/29/2007. Effective for the current fiscal period at that date and retroactive to the start of the 2007 calendar year.

Law 26270 (published in the Official Gazette on 7/27/2007) Promotion of Development and Production of Modern Biotechnology – A promotion regime is established for the development and production of biotechnology.

The beneficiaries of the projects will be entitled to the following benefits:

- Income tax: Accelerated depreciation of capital goods, special equipment, parts or components of newly acquired goods destined for the promoted project;
- Value added tax: Early refund of the tax applicable to the assets acquired for the project;
- Social security contributions: The amount representing 50% of social security contributions actually paid on the payroll salaries involved in the project shall be converted into a tax credit bond that may be applied to payment of national taxes.

Duration: Fifteen years counted as from the date of enactment.

Law 26276 (published in the Official Gazette on 8/13/2007) Double Taxation - Amendment Protocol - Protocol of Amendment to the Convention to avoid double taxation and prevention of income and property tax evasion, dated April 4, 1979, signed by the Argentine and the French Governments in Buenos Aires on August 15, 2001. This Protocol has amended the taxes covered by it and redefined the terms regarding the manner in which double taxation will be avoided in each country. The Protocol came into force on October 1, 2007.

Law 26287 (published in the Official Gazette on 8/30/2007) Income tax - Personal deductions for fiscal year 2007 - The wording of the tax law has been amended increasing the following personal deductions applicable to workers:

- Spouse: \$ 8,000.
- Children: \$ 4,000.
- Special deduction: the amount of \$ 7,500 remains in effect, having increased to \$ 36,000 for those under the payroll withholding system, pursuant to Article 79, clauses a), b) and c) of the Income Tax Law.

The abatement of personal deductions shall start to apply in the case of net income higher than \$ 91,000, without modifications in the percentages of reduction of deductions for such income.

Effective date: These provisions shall apply as from fiscal year 2007, effective 1/1/2007.

Decree 1234/2007 (published in the Official Gazette on 9/18/2007) Industrial Promotion - The validity of the rights and obligations established within the framework of Law No. 19640, Decrees Nos. 479/1995 and 490/2003 for industrial companies based in the Province of Tierra del Fuego, the South Atlantic and the Sub-Antarctic Islands has been extended until 12/31/2023.

It is also clarified that said benefit applies to the projects currently in force, as well as to those industrial projects pending before the Competent Authority, which are classified under the regime established by decree 490/2003, after the effective date of the decree mentioned above.

Law 26317 (published in the Official Gazette on 12/10/2007) Personal Property Tax - Law 23966; its amendment - These provisions set the rates applicable to individuals domiciled in Argentina and undivided estates situated in Argentina owning assets valued in excess of \$ 305,000 (three hundred and five thousand pesos). Those taxed assets whose aggregate value is equal to or lower than that amount shall not be subject to this Tax.

Taxed assets in Argentina owned by foreign beneficiaries shall be levied at a rate of 1.25% (one point twenty five percent).

The provisions of this law shall apply for fiscal 2007 and subsequent periods.

Law 26340 (published in the Official Gazette on 12/28/2007) Tax on credits and debits in bank accounts. Additional emergency tax on the final sales price of cigarettes. The tax on credits and debits in bank accounts and the additional emergency tax on cigarettes will continue to apply until December 31, 2008.

Effective date: December 28, 2007.

4. Outlook

On the political front, President Cristina Fernández de Kirchner, elected by 45.29% of the electorate, will govern in 2008 with an absolute majority in both chambers of the National Congress. So, strong opposition in Congress to the diverse bills proposed by government officials is not anticipated.

A volatile international context, associated with the deceleration of the North American economy, will mark the first year of her mandate. According to a survey done by PwC, only 35% of North American CEOs indicated that they were “very confident” about growth in their country over the next year, compared to 53% in the previous year.

Still, it is worth noting that expectations about North American growth increase when the timeframe is extended to three years. So, there is reason to believe that the potential North American recession will not have strong and lasting effects on the Argentine economy, backed up as well by its growth which is fundamentally based in the domestic market; a relatively high exchange rate; a surplus on fiscal and external planes; as well as strong growth in China and India, that will act in a certain measure as a counterweight in the demand for commodities.

In summary, the challenges of major importance for the present year will be concentrated in controlling price levels and public costs to maintain the fiscal surplus; undertaking actions to solve the energy crisis; increasing investments and normalizing the international financial situation through negotiable resolutions with the Paris Club.

5. Principal economic indicators

	2006***	2007***	Variations	Sources
GDP* (current Ar\$)	654.4	812.1	24.1%	MECON
GDP** (current US\$)	212.9	260.6	22.4%	MECON
GDP* (Ar\$ 1993)	330.5	359.2	8.7%	MECON
GDP (Ar\$ 1993) var (%)	8.5	8.7	2.4%	MECON
GDP per capita US\$	5,356.0	6,484.3	21.1%	MECON
CPI var (%)	9.8%	8.5%		INDEC
PPI var (%)	7.1%	14.6%		INDEC
Exports**	46.4	55.6	19.8%	MECON
Imports**	34.1	44.7	30.9%	MECON
Balance of trade**	12.3	10.9	-11%	MECON
Balance of payments current account var (%)	43.1%	-11.4%		MECON
Fiscal Balance*	11.6	9.2	-20.7%	MECON
Fiscal Balance var (%)	23.4%	-20.0%		MECON
Gross Fixed Domestic Investment* (Current Ar\$)	152.8	197.5	29.2%	MECON
Investment as % of GDP	23.0%	24.0%		MECON
Foreign Debt**	109.1	118.0	8.2%	MECON
Foreign Debt as a % of GDP	51.2%	45.3%		MECON
Foreign Debt in years of exports	2.3	2.1	-8.7%	MECON
International reserves of the Argentine Central Bank**	32.1	46.2	44.0%	BCRA
International reserves as a % of the foreign debt	32.7%	39.1%	19.6%	MECON

* In billion of Ar\$

** In billion of US\$

*** Last Available Data

PricewaterhouseCoopers in Argentina

PricewaterhouseCoopers (www.pwc.com/ar) provides professional services of auditing, tax advice and legal and advisory, with a focus on different industries in both the public and private sector.

Our office in Buenos Aires, Argentina was established in 1913 to become the first in the Central and Southern Americas. For more than 90 years, our Firm has led the Argentine market, from four strategically-placed offices in Buenos Aires, Cordoba, Mendoza and Rosario, on the basis of three pillars: support, accuracy and flexibility.

We are convinced that the dynamic of business requires that advice be not only limited to the reviewing of facts, but must also necessarily understand the active participation of the consultant in the solution to problems.

March 2008

Highlights of Argentina was produced by the Advisory Deals Team and Tax Services Team of PricewaterhouseCoopers of Argentina.

pwc.com/ar

ar-marketing@ar.pwc.com

©2008 Price Waterhouse & Co. S.R.L., Price Waterhouse & Co. Asesores de Empresas S.R.L., PricewaterhouseCoopers Jurídico Fiscal S.R.L. and PricewaterhouseCoopers Asesores Gerenciales S.R.L. All rights reserved. PricewaterhouseCoopers refers to the argentinian firms of Price Waterhouse & Co. S.R.L., Price Waterhouse & Co. Asesores de Empresas S.R.L., PricewaterhouseCoopers Jurídico Fiscal S.R.L. y PricewaterhouseCoopers Asesores Gerenciales S.R.L. or, as the context requires, the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity. *connectedthinking is a trademark of PricewaterhouseCoopers.