

Highlights of Argentina

A wrap-up of 2006 and a forecast for 2007*



1 Overall context

After four and a half years of vigorous growth, economic activity showed no sign of slowing in 2006, and a wide range of economic indicators suggest that the process of economic expansion will continue through 2007.

The current dynamism of economic activity continues to have a positive impact on employment and recovery of real income levels, particularly in the lower-income segments, giving rise to a steady decline in poverty and indigence, and an improvement in income distribution.

Public accounts continue to record both primary and financial surpluses, meeting budget targets. Revenue and spending estimates for 2007 show that budget targets for fiscal results are also likely to be met, although public spending posted a significant increase at the end of 2006, which if it persists could lower the fiscal result planned for 2007.

Prices have been contained by the government's price policy implemented as from March, 2006. In addition, fiscal strength and the incomes and monetary policies adopted have contributed to lower inflation expectations during 2006. One possible risk on the inflation front in 2007 is that price policy could discourage investment in certain sectors, at the same time as building up pressure that might generate greater inflation expectations in future.

The external sector remains robust, with both the current account surplus and the trade balance matching the rate of nominal output growth.

Meanwhile, the international outlook continues to be beneficial for Argentina. In addition to the strong increase in the international prices of our export products, there has been a decline in the risk of a "crash landing" caused by international imbalances, with the beneficial effect of interrupting the upward trend in interest rates.

In effect, the Argentine economy has succeeded in consolidating its growth in the four years since the crisis. Looking forward, current capacity utilization levels in manufacturing industry will ensure that investment will be a determining factor for the economic growth rate, in a situation in which demand is expected to maintain its upward trend.

2 Economic indicators

GDP

In 2006 GDP at 1993 prices rose 8.4% in year-on-year terms, to Ar\$330.5 billion. The statistical carry-over into 2007 will be 3.3 percentage points, so that the Argentine economy will grow by this amount compared with 2006 even if there is no improvement on the levels of the last quarter of 2006.

Figures on aggregate demand for the year show that the rising investment rate has again played a leading role, having increased 19% during the year to a level of 23% of GDP.

Consumption by the private sector continues to drive economic growth, contributing 5.1 percentage points to economic expansion in the last year.

The Monthly Economic Activity Estimator, which predicts the development of Output at constant prices, recorded year-on-year growth of 7.6% in December 2006, and 8.4% in January 2007, giving notice of a steady growth trend for the whole of 2007.

Balance of payments and trade balance

The capital account of the balance of payments recorded a negative US\$5.7 billion in 2006 because of the payment in full of the country's debt to the IMF at the beginning of the year, partly offset by sales of securities to non-residents.

The current account posted a surplus of US\$8.1 billion, showing a significant improvement on 2005 because of a higher surplus from the merchandise account.

As a result, Central Bank reserves went up US\$3.5 billion, to a total of US\$32.0 billion. By March 14, 2007 they had reached US\$35.7 billion, the highest level in their history.

In 2006 exports rose by 15% to US\$46.6 billion, 8 percentage points being accounted for by higher prices, and 7 percentage points because of increased quantities. Imports were 19% higher at \$34.2 billion, 17 percentage points being due to greater quantities, and 2 points to higher prices.

This performance led to a trade surplus of US\$12.4 billion that was once again mainly responsible for the abundant supply of US dollars on the exchange market.

Public and External Debt

The total public debt at September 30, 2006 amounted to US\$129.6 billion, equivalent to Ar\$402.3 billion, and includes arrears for US\$4.8 billion.

At the end of 2006 the external debt was US\$4.5 billion lower than at the end of 2005, mainly because of the settlement by the Central Bank of the US\$9.5 billion debt with the IMF in January 2006 and other net payments of capital to international agencies. Nevertheless, other factors during the year moderated this effect, including the conclusion of debt restructuring processes, new placements that began to be placed at the end of the year, and increased trade finance linked to the rising volumes of foreign trade.

Industrial Activity

Industrial activity performed very positively, rising by 8.3% year-on-year. The sectors with the highest growth were the Automotive and Non-Metallic minerals sectors (the latter for use by the construction industry). The strong growth seen in these sectors was encouraged by the recovery in personal credit, and rising real purchasing power.

Unemployment and Poverty

In 2006 the unemployment rate dropped to 8.7%, if those participating on welfare schemes are considered to be employed (if not, the rate rises to 10%).

By the second half of 2006 the population below the poverty line had dropped to 26.9%, a figure that is nevertheless still higher than in the pre-crisis period.

Inflation and Exchange Rate

In line with the decision by the Central Bank to build up reserves and maintain a high rate of exchange, at the end of December 2006 the peso closed at Ar\$3.07 per US\$1, a devaluation of 5.5% compared with the same month of the previous year. On March 2007 the rate was Ar\$3.1 per US\$1.

From the figures recorded in 2006 it appears that wholesale and retail prices have slowed their rate of increase.

Following retail inflation in 2005 of 12.3%, 2006 concluded with inflation of 9.8%. This was possible thanks to a series of price agreements that the Government reached with the private sector as from March, focusing principally on those segments with a strong impact on CPI, leading in practice to very low price increases for these segments as from the beginning of the year. On March 2007 retail prices showed a slight 0.8% increase for the month.

Interest Rates

The country risk premium declined steadily over the course of 2006, reaching its lowest ever level close to the end of the year. This favorable situation, combined with a beneficial international context, has had a positive impact on capital inflows from foreign investors.

Interest rates remained steady over the year, a consequence of active intervention in the financial sector by the Government and the Central Bank. It should be noted that in real terms, deposit rates continue to be negative.

Fiscal Accounts

National accounts continued to show positive signs. Rising revenue figures were essential to the preservation of the fiscal surplus, and this was possible as a result of the growth in economic activity, the dynamic of foreign trade, and the impact of inflation. In 2006 the primary surplus for the National Public Sector was 3.5% of GDP, similar to the level recorded in 2005, with income at Ar\$158.5 billion and spending at Ar\$146.9 billion.

Recently primary spending (particularly under the Consumption, Current Transfers and Capital Expenditure headings) has begun to rise at a faster rate than tax revenue, and if this trend continues, there could be a drop in the primary surplus in 2007.

3 Taxes

In 2006 the tax legislation has not been amended significantly. The most significant changes are as follows:

Income Tax

Personal Deductions

General Resolution 2005 (published in February 2007) introduced an annual tax deduction of up to AR\$ 6,000 for the social security contributions and compensation paid for domestic personnel employed by the taxpayer.

Decree 314 (published in March 2006) increased the annual deductible allowances:

	AR\$
- Minimum non-taxable income	6,000
- Special tax allowance for employees	22,800
- Allowance for spouse	4,800
- Allowance for each child	2,400
- Allowance for other authorized dependants	2,400

National Secured Loans

Decree 1035 (published in August 2006) established that the exchange difference resulting from the conversion of Argentine treasury securities in foreign currency to Guaranteed Government Loans in local currency and the application of the respective monthly adjustment (Reference Stabilization Coefficient - CER) is considered as taxable income. However, the taxpayer may opt to allocate the respective income to the fiscal period of disposal of the loan instrument rather than to each holding year.

Value Added Tax

General Resolution 2000 (published in February 2006) established new rules in relation to the reimbursement of VAT on exports and similar transactions. Procedures regarding the export of services have been regulated and the application may include the transactions invoiced within the last 48 months.

By Law 26,258 (published in November 2006) individual taxpayers are allowed to request VAT refund or to apply it against other tax liabilities, with respect to VAT arising from purchase, construction, import of goods or rendering of services relating to the purchase of his abode.

Tax Procedure

By General Resolution 1995 (published in January 2006) the taxpayer may opt to be registered with the tax authorities with an electronic fiscal domicile. Accordingly, all correspondence and notifications will be duly sent to the respective e-mail address.

By Resolution 492 (published in June 2006) the monthly interest rate for late payment of tax obligations has been raised to 2%, and to 3% as from the time the tax liability is claimed by Court.

Other Matters

Tax Incentive for Investment in Fixed Assets

Resolution 37 (published in February 2006) established the requirements for the accelerated depreciation and application for anticipated VAT reimbursement in case of investors who purchased fixed assets for industrial use.

Tax Incentives for the Oil & Gas Industry

Law 26,154 introduced benefits to the Oil & Gas sector to encourage the exploration of the nation's hydrocarbon reserves. Special incentives are granted to investments in underdeveloped regions, speeding reimbursement of VAT (after a three-month period, inputs will be credited against other federal taxes or returned to the taxpayer), exempting from import duties and offering an accelerated depreciation within three years for income tax purposes.

In addition, a three-year relief from minimum notional income tax, which is levied at 1% on the company assets, is provided by the law.

The incentive package will be in effect for 15, 12 or 10 years, depending on whether the activities are performed in areas identified as i) continental platform, ii) within the country other than continental platform and iii) currently in production, respectively.

Tax Incentives for Biological Fuel

Law 26,093 introduced tax incentives for the production and use of biological fuel by offering benefits regarding VAT, income tax, minimum notional income tax, the tax on liquid fuels and natural gas with effect for 15 years.

Tax Treaties

By Law 26,185 (published on January 3, 2007), the Tax Treaty entered into between Argentina and Russia has been approved and will have effects as from January 1st of the fiscal year in which both States exchange the corresponding notifying documents.

4 Outlook

Although it is difficult to continue growing at the same pace seen during the last four years, in the short run the economy is expected to maintain its upward trend.

Domestic investment continues to increase, driven by higher profits in most areas of economic activity. This trend is in part a consequence of a favorable international context, but is also due to the strong recovery by the domestic economy over the last four years.

It has to be pointed out that in 2007, a new President will be elected. The increase in public spending that is generally associated with election years could put more pressure on prices.

The Government still needs to undertake long-delayed reforms to encourage the level of investment, the determinant factor to satisfy growing demand and maintain sustainable growth of the economy.

5 Principal economic indicators

	2003	2004	2005	2005 ¹	2006 ²
GDP ** (Current AR\$)	375.90	447.60	531.90		654.40 (e)
GDP *** (Current US\$)	126.70	149.10	181.60		211.10
GDP ** (AR\$ 1993)	256.00	279.10	304.80	299.60	330.50
GDP per cap. US\$	3,424	3,983	4,802		5,636
GDP var (%) (AR\$ 1993)	8.83	9.02	9.20		8.40
CPI var (%)	3.70	6.10	12.33	11.09	9.80
WPI var (%)	2.00	7.86	10.74	9.66	7.10
Exports ***	29.60	34.50	40.40	36.59	46.60
Imports ***	13.80	22.40	28.70	26.15	34.20
Balance of trade ***	15.80	12.10	11.70	10.40	12.40
Balance of payments current account var (%)	-14.10	-56.50	68.01	35.95	43.10
Fiscal balance **	1.80	11.63	9.42	8.82	11.60
Fiscal Balance var (%)	-139.50	546.11	-19.21	-28.97	23.40
Gross Fixed Domestic Investment ** (Current AR\$)	56.90	85.80	114.10	106.45	153.50
Investment as % of GDP	15.10	19.16	21.46		23.00
Foreign debt ***	165.00	170.80	113.80	115.60	109.10
Foreign debt as a % of GDP	130.23	114.55	62.66		51.70
Foreign debt in years of exports	5.60	5.00	2.80		2.30
International reserves of the Argentine Central Bank***	14.12	19.65	28.08		35.70
International reserves as a % of the foreign debt	8.56	11.50	24.67		32.70

¹ Same date at last data 2006

² Latest available data

** In billions of AR\$

*** In billions of US\$

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