Argentina—Letter of Intent, Memorandum of Economic Policies, and Technical Memorandum of Understanding

Buenos Aires, Argentina
January 16, 2003

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Köhler:

The attached Memorandum of Economic Policies describes the economic program and objectives of the Government of Argentina for the first six months of 2003. In support of this program, the Government requests a Stand-By Arrangement in the credit tranches from the Fund for the period through August 31, 2003 in an amount equivalent to SDR 2.1745 billion. We also request that the repurchase expectations arising during the arrangement period be moved to an obligations basis, and hereby cancel Argentina's existing Stand-By Arrangement, which was approved by the Fund in March 2000.

We are firmly committed to ensure the continued timely honoring of the obligations that the Republic of Argentina has to the International Monetary Fund. In this context, we request that under the proposed new Stand-By Arrangement, amounts be disbursed in SDRs and held in the SDR account of the Republic of Argentina, solely for the purpose of the timely honoring of the obligations of Argentina to the International Monetary Fund. We do not intend to convert SDR amounts in foreign currencies for other purposes. Accordingly, we confirm that the Treasurer's Department of the International Monetary Fund is authorized to debit the SDR account of the Republic of Argentina when obligations of the Republic to the Fund become due.

During the period of the requested arrangement, the Government will maintain a continuous dialogue with the Fund, in accordance with the policies on such consultations, on the adoption of any measures that may be appropriate to achieve the objectives of the program. Reviews under the arrangement will be completed by March 14, 2003, May 15, 2003, and July 15, 2003. These reviews will be associated with financing assurances reviews and will assess overall performance under the program, compliance with the IMF's Lending into Arrears Policy, and observance of the performance criteria for end-January, end-March, and end-May, respectively.

Sincerely yours,

/s/	/s/
Dr. Roberto Lavagna Minister of Economy	Lic. Alfonso Prat-Gay President of the Central Bank

Memorandum of Economic Policies of the Government of Argentina for a Transitional Program in 2003

I. Introduction

1. The government has formulated a short-term transitional program aimed at maintaining macroeconomic stability and strengthening economic recovery during the upcoming political transition. Presidential elections are scheduled for April 2003 and a newly elected government will take office in late May. The transitional program will lay the foundation for a more comprehensive program of fundamental reforms that will be developed after the elections and that is needed to tackle the deep structural problems that confront Argentina. The key objectives of the transitional program are to ensure fiscal, monetary, and banking soundness and to rebuild domestic and foreign investor confidence by maintaining equal treatment of all parties, protecting contract rights, and defending the rule of law.

2. The main components of the transitional program are: (i) the 2003 budget, which seeks to keep the federal fiscal deficit under control; (ii) implementation of the federal-provincial bilateral pacts; (iii) a monetary program to maintain inflation at a low level; (iv) preparatory steps toward structural measures needed to strengthen the fiscal position over the medium term; (v) progress toward debt restructuring; (vi) a strategy to restore the health of the banking system; and (vii) ensuring full respect for the rights of creditors, restoring legal certainty, and making a start on corporate restructuring.

3. We will observe the standard performance criteria against imposing or intensifying exchange restrictions, multiple currency practices, and import restrictions for balance of payments reasons. Quantitative performance criteria and indicative targets of the program are set out in Table 1 and in the attached Technical Memorandum of Understanding (TMU). There will be three program reviews, including for financing assurances.

II. Macroeconomic Policies for 2003

A. Macroeconomic Framework

4. The macroeconomic framework for 2003 assumes that real GDP grows by about 2-3 percent (compared to an estimated decline of 11 percent in 2002) and that 12-month consumer price inflation could be held within 35 percent by the end of the year. A significant current account surplus is projected of about US$6.5 billion in 2003. Gross international reserves are targeted to be broadly unchanged over the period of the arrangement. IFI lending to Argentina is assumed to cover obligations falling due to these institutions during the period January-August 2003, including the clearance of arrears.

B. Fiscal Policy and the Social Safety Net

Overall aims

5. The public finances are being adapted to a sharp reduction in domestic and international financing. The consolidated government (cash) primary surplus is targeted to rise to about 2½ percent of GDP in 2003 (compared to broad primary balance in 2002), of which about 1.8 percent of GDP is expected to be realized during the January-August period. Social programs have been adapted to alleviate the worst effects of the economic crisis.

The Federal Government.

6. The 2003 budget was approved by congress on December 26, 2002 with measures sufficient to achieve a (cash) primary surplus of 1.9 percent of GDP (up from an estimated 0.5 percent of GDP in 2002). The approved budget eliminated a contingency allocation of Arg$3½ billion—originally intended for use by the incoming government—and made further cuts in primary spending of about Arg$1 billion. Several spending initiatives introduced by Congress were vetoed by presidential decree on January 9, others will be accommodated through reductions in other spending programs. In addition, some revenue measures will be resubmitted to Congress in order to reach the original targeted primary surplus of 2.1 percent of GDP.

7. *Revenue measures*. A presidential decree was issued in November 2002 capping the use of federal bonds for federal tax payments at Arg$80 million per month, and legislation was passed in December prohibiting the Executive from granting future tax amnesties. In addition—after the two-month temporary cut introduced by decree in November 2002 — the VAT rate will revert to the 21 percent standard rate on January 18, 2003, as provided for in the executive decree. Legislation to suspend the remaining competitiveness plans for the agriculture, transportation, and the media sectors will be reconsidered by the Congress in February. It is our intention that all competitiveness plans be eliminated by end-March, 2003. In February 2003 the government will also resubmit to Congress legislation to convert the fuel tax to an ad-valorem basis and to eliminate the income tax exemption on export rebates.

8. *Expenditure policy*. A ceiling on primary spending (excluding transfers to provinces) has been set at Arg$45.9 billion, a decline of 1½ percent of GDP compared to 2002. Of this amount, personnel expenditures and pensions are budgeted at Arg$27.9 billion. The reinstatement of the court-ordered 13 percent wage and pension cut implemented between July 2001 and December 2002 will be made in the form of bonds that do not amortize in 2003. Adequate resources will be provided to service: (i) phase one debt and other bonds issued in the deposit exchange programs; (ii) compensation bonds issued for the asymmetric *pesoization,* the asymmetric indexation of banks' assets and liabilities, and for bank capital losses incurred as a result of court injunctions (*amparos*) to release reprogrammed time deposits; and (iii) all obligations to the IFIs.

9. *Central bank transfers and credit to government*. The central bank will transfer only realized profits to the federal government up to Arg$1 billion in 2003. Central bank credit to the government in 2003 will be strictly limited in line with the agreed program. A phased strategy for the redemption of quasi-monies will be agreed with the IMF staff during the second program review.

Social safety net

10. Total spending on the social safety net is projected to broadly double from 0.6 percent of GDP in 2001 to 1.2 percent of GDP in 2003. A principal component is the new Heads of Household (*Jefes y Jefas de Hogar Desempleados*) program. The World Bank Executive Board is expected to consider a loan for the program after the clearance of arrears, which is

expected by January 23, 2003. The program targets about 1.7 million beneficiaries. As part of its governance and transparency, we have ensured that: (i) at least 80 percent of the beneficiaries meet the eligibility requirements; (ii) at least two-thirds of the beneficiaries participate in eligible work activities; and (iii) regular audits (including external) and supervision in field are held, with the first two audits already undertaken. In addition to this program, and in coordination with the IDB and the World Bank, we are reallocating expenditures toward emergency health, education, and nutrition programs.

Provincial governments

11. Provincial adjustment is underpinned by the federal-provincial pact on temporary revenue-sharing arrangements signed in February 2002, which abolished the floor on transfers to provinces and aimed at eliminating provincial deficits by 2003. Provincial adjustment is being achieved through spending controls, administrative reforms, reporting requirements, and penalties for noncompliance. The provinces that have signed the bilateral agreements have terminated all new issues of provincial treasury bills and quasi-monies and the federal government has also ceased issuing *Lecops*. Under the bilateral agreements, the provinces have consented that the federal government would apply future co-participation transfers to accelerated repayment of debt to the federal government in the event that a province issues any new quasi-money. In the event that a province exceeds its deficit target, orderly financing will be correspondingly reduced.

12. On this basis, the provincial governments are targeted to achieve a primary surplus of 0.4 percent of GDP in 2003 (after an estimated deficit of about ½ percent of GDP in 2002). By March 14, 2003, the governors of provinces accounting for at least 80 percent of the 2002 consolidated provincial deficit are expected to sign the supporting bilateral agreements for 2003 committing them to the fiscal targets; by the second program review, it is expected that provincial legislatures will ratify all the bilateral agreements.

13. In addition to the reporting requirements of provinces specified in the bilateral agreements, the federal government and the central bank have established a system of below-the-line monitoring of financing transactions. This system records all financing transactions of the provinces by tracking the movements in provincial government deposits, including quasi-monies, the issuance of provincial bonds, the issuance of any other provincial debt (including debt service arrears), privatization receipts, and the amortization of provincial debt. This information will be provided to the Fund on a monthly basis with a delay of less than 55 days after the end of the reporting period, beginning with data for January 2003.

14. The central bank has prohibited banks from lending to local governments (provinces and municipalities), as well as from using future revenue-sharing transfers as loan collateral. In addition, if the provinces issue quasi-monies, the federal government will not support their participation in debt markets, or the receipt of IFI financial support—except under emergency social programs—until the provinces redeem the quasi-monies issued.

Public debt

15. The change in federal government debt during end-December 2002 to end-June 2003 will be limited to Arg$105 billion, as defined in the accompanying TMU. This will bring public debt to Arg$612 billion. The ceiling includes: the assumption of provincial government debt of Arg$34 billion; Arg$8 billion in obligations incurred in previous years, but as yet unrecognized; the issuance of Arg$17 billion of bonds to financial institutions to compensate them for the asymmetric *pesoization* and indexation and the impact of *amparos* on their balance sheets; and Arg$27 billion for the effect of inflation on indexed debt.

C. Monetary and Exchange Rate Policies

16. The monetary program seeks to strengthen the nominal anchor for price expectations and to restrain foreign exchange intervention. The proposed strategy is as follows:

· Indicative targets have been established for an adjusted monetary base (defined as the nonremunerated monetary liabilities of the central bank plus the quasi-monies issued by the federal government and the provincial governments). This aggregate amounted to Arg$36.6 billion on December 31, 2002.

· The central bank will target this aggregate to return to its end-December 2002 level by August 2003, following a temporary increase during February and March. Given the uncertainties in regard to money demand, the monetary targets will be reassessed at the time of each program review.

· We will consult with Fund staff if liquidity pressures on banks develop and threaten to undermine the monetary program.

· Full flexibility of the exchange rate will be maintained, with foreign exchange intervention limited to smoothing disorderly market conditions.

17. Operationally, the monetary program will be implemented through a ceiling on central bank net domestic assets (NDA) (adjusted for quasi-monies) and a floor on net international reserves (NIR) (as specified in the accompanying TMU). Monetary policy will be conducted mainly through open-market auctions of central bank bonds at freely determined interest rates.

D. Program Financing

18. The total external financing need is estimated at US$11.6 billion for the period January 1-August 31, 2003, including the clearance of arrears to the IFIs. This estimate of the financing need assumes a temporary accumulation of arrears on phase two debt that will be addressed as set out in section III below. The financing need is expected to be met by new disbursements by the Fund of about US$2.9 billion and the extension of repurchase expectations amounting to US$3.7 billion, new disbursements from the World Bank and the IDB broadly equivalent to amounts falling due to them (US$4.4 billion), and a requested rescheduling of obligations to Paris Club creditors (US$0.7 billion). The government will not accumulate arrears to bilateral or multilateral creditors during the program period.

E. Exchange Controls

19. As the economic and financial crisis deepened, the government found it necessary to impose a large number of exchange restrictions and controls which we are beginning to dismantle as economic stability is gradually restored. Specifically, effective January 16, 2003, Article VIII restrictions in the following areas have been eliminated:

· The prior authorization requirements for external transfers related to interest payments, profit remittances, and dividend payments. In addition, the government remains prepared to provide foreign exchange for payments of reinsurance premiums for all transactions that are shown to be legitimate.

· The prior authorization requirement for foreign exchange sales to nonresidents in cases where residents have access to foreign exchange for transfers (which cover all current transactions).

20. A proposal to modify the prior authorization requirement for external payments of principal on loans will be made at the time of the first review.

21. In addition, effective January 8, 2003, the ceiling on the export surrender requirement to the BCRA was raised to US$1 million. At the time of the first review of the program, we will assess the scope for the further liberalization of the export surrender requirement and the remaining foreign exchange controls.

F. Privatized Utilities

22. We have requested IMF/World Bank assistance to review in February the financial situation of the privatized utilities and to help develop a new regulatory framework that would replace the present price and tariff controls, and facilitate debt restructuring by the utility companies.

III. Medium-Term Framework and Debt Restructuring

23. The medium-term strategy aims at restoring a real GDP growth rate of around 3½ percent over the medium term, with inflation brought down to around 5 percent or less from 2004 onwards. The real exchange rate is expected to appreciate from the depreciated levels of 2002, but would remain below its pre-crisis level contributing to a further strengthening of the balance of payments.

24. The government recognizes the critical importance of fiscal reforms at both the federal and provincial level, which, along with the improvement in the macroeconomic environment, are needed to sustain over the medium term an annual primary balance of the consolidated government substantially higher than in 2003. To support this fiscal effort—which would be unprecedented in Argentina's recent history—the government has committed to preparing key legislation related to structural fiscal reforms. Specifically, with technical assistance from the IMF, the government will, by the second review of the program, prepare draft legislation that provides for:

· A comprehensive reform of the tax system aimed at: (i) a substantial reduction in tax exemptions and preferential tax rates; (ii) a substantial reduction in regional promotion schemes; (iii) broadening the income tax base to include interest and dividend income and the profits of cooperatives and foundations; and (iv) a phased increase in the rate of the diesel excise to bring it in line with the rate for gasoline.

· A reform of intergovernmental relations that would include: (i) a simplification of the rules related to the primary distribution; and (ii) would link more closely the secondary distribution of transfers to the revenue capacity and expenditure needs of each province.

25. We will strengthen the collaborative approach toward restructuring public debt held by private creditors. With a view to securing a high participation rate, we are committed to achieving an adequate degree of intercreditor equity in the restructuring. Payments on restructured instruments will be consistent with the envelope of resources that Argentina can generate and, over the medium term, can reasonably expect to mobilize from private capital markets.

26. Our debt management team will work closely with Argentina's legal advisors in the restructuring of the debt. We have issued terms of reference for the appointment of external advisors to assist in managing relations with creditors and in preparations for debt-restructuring negotiations. We have conducted initial meetings with bondholders in the United States, Europe, and Japan, and we will maintain regular contacts with creditors in the period up to the completion of the restructuring. We have explained the strategy

outlined herein in contacts with creditors, including by dissemination of the strategy on the ministry of economy website. We have invited comments from creditors, including on issues of process, appropriate representation, and types of instruments to be offered in the restructuring and we would respond promptly to these comments. We will continue to share relevant nonconfidential information with creditors on a timely basis.

27. In the period leading up to the commencement of full restructuring discussions we will pursue a number of preparatory steps in consultation with Fund staff, including:

· Appointing external advisors by the first review of the program.

· The preparation of a database on the types of creditor, and magnitude of holdings, based on our own databases, and the ongoing dialogue with creditors, by the second review.

· Further the dialogue with creditors on procedural aspects of the restructuring, including representation issues, methodology for establishing creditors' claims, and means of tailoring restructured instruments to investors' needs.

28. With regard to debt service to official bilateral creditors, the Government of Argentina has initiated preliminary contacts with Paris Club creditors aimed at establishing the parameters for a debt rescheduling, including the definition of the cut-off date, that can make an effective contribution to debt sustainability.

IV. Banking System Reforms

29. The government is taking steps to restore the health of the banking system to ensure it supports economic recovery and provides a basis for sound macroeconomic management.

· The institutional basis for bank resolution has been strengthened through the creation of a bank resolution unit—*Gerencia de Supervision Especializada* (GSE)—with responsibility for implementing banking resolution actions for nonviable banks. The GSE will report directly to the Executive Board of the central bank.

· Procedures for resolving problem banks are to be strengthened through agreed amendments to the financial institutions law that will: (i) facilitate asset transfers by the BCRA Board to private financial trusts; (ii) establish valuation rules for asset transfers; (iii) clarify central bank powers to provide emergency liquidity support to banks under rehabilitation; (iv) establish procedures for the rapid judicial appointment of receivers in banks under resolution; (v) limit the ability of the judiciary to reverse central bank decisions on asset transfers to third parties; (vi) strengthen the creditor rights of purchasers and managers of transferred assets; and (vii) protect public officials from aspects of the present legislation that can result in challenges or compensatory claims against acts performed in a bank restructuring and rehabilitation process. The amendments are to be submitted to Congress by March 14, 2003, with passage expected by the second review of the program.

· Depositor protection has been clarified through the establishment of a temporary depositor protection system, whereby depositors in closed banks are provided the option of receiving government bonds. In case the option is not exercised, deposit holders will be paid out of liquidation proceeds according to the banking law.

· Agreed mechanisms will be created to compensate banks for the adverse effects on their balance sheets of the asymmetric indexation of their assets and liabilities and the *amparos*. These mechanisms are expected to be announced by the first program review.

· The supervisory and prudential framework will be strengthened through revisions to banking regulations that establish norms for foreign exchange exposure, update commercial loan classification requirements, and regulate the valuation of government loans and bonds. The revisions are to be completed by end-February 2003.

· Timely bank reporting will resume. Banks have been instructed to report September and December 2002 financial statements by end-February 2003 together with business plans/cash flow projections for 2003-04. On the basis of these reports, by May 15, 2003, the central bank will announce a minimum capital adequacy ratio for a transitional period and assess and classify banks.

· The basis for central bank liquidity support of banks will be clarified. Liquidity support will be provided on a uniform basis to all banks (public and private) and resolution triggers for banks relying excessively on such support would be introduced. The appropriate regulations are expected to be issued by mid-February 2003.

· Reform of the three main public banks is being initiated**.** In February 2003 , documents will be issued launching the bidding process for international accounting firms to conduct due diligence examinations and for an international management consultant to: (i) advise on measures to control costs, improve risk management, and help prepare feasible business plans; and (ii) conduct a strategic review of Banco de la Nación, Banco de la Provincia de Buenos Aires, and Banco de la Ciudad de Buenos Aires. The terms of reference are being developed in consultation with the IFIs. Following selection of the international accounting and consulting firms, the work is expected to be completed within a three-month period. Based on recommendations from the international advisors, decisions will be taken on: (i) a time-bound action plan to improve operational performance; (ii) strengthening management; and (iii) the future strategic role of the public banks, including decisions on capitalization through public share issue. Meanwhile, lending by the two largest public banks is being restrained by requiring at least 50 percent cofinancing with a private domestic bank for all loans in excess of Arg$1 million.

· The autonomy of the central bank is to be strengthened through legislation aimed at: (i) allowing the central bank to appoint its own personnel; and (ii) providing budgetary independence to the central bank. This legislation will be submitted to Congress by the first review of the program and is expected to be approved by the second review.

· The central bank will work with Fund staff to develop a presentation of their financial statements on the basis of international accounting standards with effect from the 2003 financial year.

V. Legal Reform and Corporate Restructuring

30. We recognize the critical importance of restoring domestic and foreign investor confidence in the rule of law and inviolability of contracts. Key measures toward this end have included: (i) the repeal of the "economic subversion" law that was of significant concern to the investor community; and (ii) the reversal of problematic provisions of a February 2002 emergency insolvency law that had eroded creditors' rights in important respects. A provision from the February emergency law that suspended certain creditor enforcement actions was modified and extended for an additional 90 days in August 2002 . This provision expired in November 2002 , following which the Bankers' Association announced a further voluntary extension that will expire in February 2003. At the end of this voluntary extension, the government will ensure that no further steps are taken to involuntarily restrain the enforcement of creditors' rights, and that all provisions of the insolvency law will remain fully in effect. Foreclosure proceedings of nonfinancial creditors in relation to small- and medium-sized companies will be reviewed (by the first

program review) in collaboration with IMF staff. Throughout the program period, no statute or other legal instrument will be adopted that provides a means for any involuntary suspension of creditors' rights.

31. The government is also working toward a comprehensive program to support voluntary out-of-court workouts between financially troubled companies and their creditors. The guiding principles in the government's approach are that: (i) no fiscal resources will be made available to guarantee corporate sector exchange rate risk or otherwise subsidize corporate debt servicing or repayment; and (ii) there will be equitable treatment of creditors and debtors. A draft law on corporate workouts is to be submitted to Congress by the first review and is expected to be passed into law by the third review. Designed in consultation with banks and other key stakeholders, this law would: (i) allow a qualified majority of a debtor's creditors to agree to a stay that is binding on all creditors; (ii) encourage the provision of new financing to troubled companies by according a specified priority to such financing; and (iii) encourage parties to enter into restructuring agreements by providing for protection of payments made under such agreements, under certain circumstances, in the event of a subsequent bankruptcy of the debtor. Separate from these provisions (which are available for medium and large companies), the draft law also contains new expedited procedures for smaller companies with liabilities under US$1.2 million which, at the option of the debtor, could include mediation in advance of an accelerated court-supervised restructuring.

32. The success of out-of-court workouts depends ultimately on the strength and predictability of the formal insolvency law. Over the next few months, we will prepare a package of definitive insolvency law amendments directed towards this end that will be readied for submission to Congress by the new government.

Table 1. Argentina: Quantitative Performance Criteria and Indicative Targets, January-June 2003 1/

(In millions of Argentine *pesos*, unless otherwise noted)

		Performance Criteria		Indicative Targets	
		end-Jan.	end-Mar.	end-May	end-June
A.	**Fiscal Targets**				
1	Cumulative primary balance of the federal government (floor)	424	1,500	3,310	4,500
2	Cumulative overall cash balance of the federal government 2/	18	-2,307	-2,708	-2,198
3	Federal government debt stock (ceiling)	515,000	576,000	603,000	612,000
4	Cumulative overall balance of the provincial governments 2/	...	-350	...	-712
5	Consolidated public sector debt stock (ceiling)	583,000	613,000	640,000	650,000
B.	**Monetary Targets**				

6	Stock of net international reserves of the central bank (in US$ millions) (floor)	-3,900	-3,900	-3,900	-3,900
7	Stock of adjusted monetary base 2/	37,250	37,650	37,200	36,400
8	Stock of net domestic assets of the central bank (ceiling)	52,265	52,665	52,215	51,415

1/ As defined in the Technical Memorandum of Understanding.

2/ Indicative targets throughout the program period.

Technical Memorandum of Understanding

This memorandum presents a detailed definition of the variables included in the quantitative performance criteria and the structural performance criteria and benchmarks for the economic program described in the Memorandum of Economic Policies of the government of Argentina to 2003.[1]

I. Fiscal Targets

A. Federal Government

1. **Performance criterion on the cumulative primary balance of the federal government**

Cumulative primary balance of the Federal Government	**Floor (In millions of Arg$)**
End-January 2003 (performance criterion)	424
End-March 2003 (performance criterion)	1,500
End-May 2003 (indicative)	3,310
End-June 2003 (indicative)	4,500

The primary balance of the federal government will cover government operations specified in the 2003 budget, and exclude privatization receipts and capital gains on the sale of financial assets. The primary balance of the federal government will be obtained from the accounts "*ahorro-inversión base caja*" published by the *Secretaría de Hacienda*. The primary balance of the federal government will incorporate transfers of realized central bank profits up to a maximum of Arg$575 million in the first half of 2003.

Debt recognition operations not accrued in previous budgets will be considered primary expenditure with the exception of those in points (i) to (iii) in item 3 below, and in point (iv) of item 3 up to the amounts specified therein.

These data will be provided to Fund staff by the *Secretaría de Hacienda* no later than 25 days after the test date.

2. **Indicative target on the cumulative overall cash balance of the federal government**

Cumulative cash balance of the Federal Government	**Floor (In millions of Arg$)**
End-January 2003	+18
End-March 2003	-2,307
End-May 2003	-2,708
End-June 2003	-2,198

The overall balance of the federal government comprises the results of the federal government and the quasi-fiscal balance of the central bank (BCRA). The coverage of the federal government is as specified in item 1 above. Interest excludes capitalization and arrears. The quasi-fiscal balance of the BCRA is defined as interest earnings on gross international reserves, plus interest on government bond holdings of the BCRA, plus net interest (cash) from domestic operations and minus profit transfers to the federal government.

Debt recognition operations will be treated as explained in item 1 above.

The overall balance of the federal government will be measured from below-the-line on the basis of: (i) the information provided by the public sector debt reporting system (SIGADE), including all short-term debt of the federal government; (ii) net asset transactions of the federal government as reported by the *Secretaría de Finanzas*, the *Dirección Nacional de Cuentas Internacionales* (DNCI) and the *Gerencia de Manejo de Reservas Internacionales* of the BCRA; and (iii) information on federal government net bank borrowing and bank deposits provided by the BCRA.

These data will be provided to Fund staff no later than 25 days after the test date.

3. **Performance criterion on the stock of federal government debt**

Federal Government debt stock	**Ceiling (In billions of Arg$)**
End-January 2003 (performance criterion)	515
End-March 2003 (performance criterion)	576
End-May 2003 (indicative)	603
End-June 2003 (indicative)	612

The stock of debt corresponds to the definition of the federal government in the 2003 budget. The program debt stock targets incorporate, among other things, the operation of the budget, the effect of inflation on debt indexed to the CER, interest arrears and interest on principal arrears[2], and the issuance of: (i) compensation bonds to the financial system[3], (ii) debt issued in the *Canje II* deposit-bond exchange (Arg$2 billion, February and Arg$5 billion, May); (iii) provincial government bonds arising from the Phase 1 debt exchange and guaranteed by the federal government (Arg $34.2 billion, February); (iv) debt recognition operations[4]. The estimate of compensation bonds to the financial system will be revised at the time of the first program review.

For purposes of this performance criterion, the term "debt" has the meaning set forth in point No.9 of the Executive Board's Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), which includes loans, leases, and suppliers' credits. The term "debt" also includes all obligations guaranteed by the federal government and contingent liabilities arising from derivatives contracts. Only debt actually placed by the test date will be included. Debt denominated in foreign currency will be valued at the market exchange rates prevailing at the test date. The following adjustments to the targets will be made:

a. Upward (downward) for the increase (decrease) in the stock of debt due to deviation of the CER and foreign exchange rates relative to the assumptions in the program (see section IV below).

b. Downward for any privatization proceeds, other asset sales, debt restructuring, by the amount of any debt retired due to "netting" operations involving write-down of central bank liquidity support against bank holdings of government debt, and by the amount of any guaranteed loans retired under the *Canje I*, *Canje II*, *Cobertura* operation.

c. Upward (downward) by any increase (decrease) in the stock of debt resulting from deviations from the assumptions set out in points (i) to (iii) above.

d. Downward by any decrease in the stock of debt resulting from deviations from the assumptions set out in point (iv) above.

e. Upward by the net increase in the stock of debt arising from any reversion of guaranteed loans issued in the Phase 1 debt exchange to their underlying securities.

The data used to monitor debt developments will be taken from SIGADE, including all short-term federal government debt. These data will be provided to Fund staff by the *Secretaría de Finanzas* no later than 25 days after the test date.

B. Provincial Governments

4. **Indicative target on the cumulative balance of the provincial governments**.

Cumulative provincial government balance	**Floor (In millions of Arg$)**
End-March 2003 End-June 2003	-350 -712

The balance of the provincial governments comprises the consolidated result of the provinces, including the city of Buenos Aires. The result of these jurisdictions will be measured from above-the-line, with expenditure defined on an accrual basis and including all spending that provincial governments pay with bonds (such as salaries paid with *Patacones*) and all interest on bonds issued by the province of Buenos Aires to recapitalize *Banco Provincia (BPBA)*, according to the information provided by the *Secretaría de Hacienda*. These limits will be indicative.

These data will be provided to Fund staff by the *Secretaría de Hacienda* no later than 25 days after the test date.

In addition, the *Secretaría de Hacienda* and the BCRA will provide the following data from below-the-line on the financing flows of the provinces no later than 55 days after the end of the test date. The data will comprise provincial government deposit changes including quasi-monies, issuance of provincial bonds, the issuance of any other form of provincial debt (including debt service arrears), privatization receipts and amortization of provincial debt. The provision of this information to Fund staff within the reporting period is a structural benchmark.

C. Consolidated Public Sector

5. **Performance criterion on the stock of debt of the Consolidated Public Sector (CPS)**.

The debt stock of the CPS	**Ceiling (In billions of Arg$)**
End-January 2003 (performance criterion) End-March 2003 (performance criterion)	583 613

End-May 2003 (indicative) End-June 2003 (indicative)	640 650

The stock of debt of the consolidated public sector includes the sum of the debt of the federal government as defined in item 3 above, that of the trust funds and PAMI, and that of the provincial governments, and the city of Buenos Aires, net of intergovernmental debt. All the adjusters specified in item 3 above apply to these targets.

The provision of the data for the provinces, trust funds and PAMI is the responsibility of the *Secretaría de Hacienda*. These data will be provided to Fund staff no later than 25 days after the test date.

II. Monetary Targets

6. **Performance criterion on Net International Reserves (NIR) of the BCRA**

Net International Reserves	**Floor (in millions of U.S. dollars)**
End-January 2003 (performance criterion) End-March 2003 (performance criterion) End-May 2003 (indicative) End-June 2003 (indicative)	-3,900 -3,900 -3,900 -3,900

NIR is defined as the difference between gross foreign reserves and liabilities to the IMF. Gross foreign reserves include the BCRA holdings of gold, SDRs, foreign currency in the form of cash, and deposits abroad, government securities of investment grade of OECD countries, and Argentina's net cash balances within the Latin American Trade Clearing System (ALADI). Liabilities to the IMF are valued at US$1.32408 per SDR. Gross and net international reserves will be evaluated at program exchange rates and be measured at the average value over the 10 working days preceding the test date and the 10 working days following the test date.

The NIR floor will be adjusted by the equivalent of net flows in foreign currency to the IFIs from January 1, 2003 that do not affect the liabilities of the central bank.

7. **Indicative target on the adjusted Monetary Base of the BCRA**

Adjusted Monetary Liabilities	**Ceiling (In millions of Arg$)**
End-January 2003 End-March 2003 End-May 2003 End-June 2003	37,250 37,650 37,200 36,400

Adjusted Monetary Base of the BCRA comprises the monetary base and the stock of provincial and federal government quasi-monies issued. Monetary base is defined as the sum of currency issue and banking system peso deposits with the central bank. The stock of quasi-monies will be measured at face value at a value of 1:1 to the peso. The monetary base will be measured at the average value over the 10 working days preceding the test date and the 10 working days following the test date.

8. **Performance criterion on adjusted Net Domestic Assets (NDA) of the BCRA**

Net Domestic Assets	Ceiling (in millions of Arg$)
End-January 2003 (performance criterion) End-March 2003 (performance criterion) End-May 2003 (indicative) End-June 2003 (indicative)	52,265 52,665 52,215 51,415

The adjusted net domestic assets (NDA) of the BCRA are defined as the difference between adjusted monetary base and net international reserves (NIR) of the BCRA.

The NDA ceiling will be adjusted by the equivalent of net flows in foreign currency from the IFIs from January 1, 2003 that do not affect the external liabilities of the central bank.

III. Structural Performance Criteria and Benchmarks

9. Continuous performance criteria, structural performance criteria, and structural benchmarks under the program are detailed in Box 1 (Attachment).

IV. Program Accounting Rates

	Jan. 2003	March 2003	May 2003	June 2003
Arg$/US$1 (e.o.p)	3.85	3.85	3.85	3.85
US$/SDR (e.o.p.)	1.32408	1.32408	1.32408	1.32408
US$/Euro	1.02	1.02	1.02	1.02
US$/CAD$	1.58	1.58	1.58	1.58
US$/JPY	121.63	121.63	121.63	121.63
US$/CHF	1.48	1.48	1.48	1.48
US$/GBP	0.64	0.64	0.64	0.64
CER coefficient (e.o.p.)	1.47	1.59	1.68	1.73

Any variable that is mentioned herein for the purpose of monitoring a performance criterion or indicative target and that is not explicitly defined, is defined in accordance with the Fund's standard statistical methodology, such as the Government Financial Statistics. For variables that are omitted from the TMU but that are relevant for program targets, the authorities of Argentina shall consult with the staff on the appropriate treatment based on the Fund's standard statistical methodology and program purposes.

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[1] At the time of the first review of the program the indicative targets for the cumulative primary balance of the federal government, the stock of federal government debt, the stock of the consolidated public sector debt, and central bank net international reserves and net domestic assets will be converted into performance criteria.

[2] The latter accumulates at 2 percent plus CER for peso-denominated debt and three-month LIBOR for foreign currency denominated debt.

[3] These include: (a) the completion of the placement of the compensation bonds for asymmetric *pesoization* (Arg$7.8 billion, February); (b) compensation for asymmetric indexation of assets (Arg$3.8 billion, May); and (c) compensation for losses arising from judicial injunctions (Arg$5.1 billion, May).

[4] These include: (a) *Bocones* (Arg$2.1 billion, spread evenly January-August); (b) other debt recognition operations (Arg$5.6 billion, January).