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# ARGENTINA

March 2020

## TECHNICAL ASSISTANCE REPORT—STAFF TECHNICAL NOTE ON PUBLIC DEBT SUSTAINABILITY

This Technical Assistance report on Argentina was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed on March 2020.

Views expressed in the report are those of IMF staff and do not represent those of the IMF's Executive Board.

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# ARGENTINA

## STAFF TECHNICAL NOTE ON PUBLIC DEBT SUSTAINABILITY

March 19, 2020

This IMF staff technical note was prepared by Fund staff at the request of the Argentine authorities. Specifically, the authorities requested that Fund staff provide its view on the envelope of debt relief that could underpin a debt restructuring consistent with restoring debt sustainability with high probability. Staff is grateful to the authorities for their close collaboration and constructive engagement throughout the process of preparing this technical note.

Staff has prepared this technical note as a form of technical assistance under Article V, Section 2(b), of the IMF's Articles of Agreement. This note is different from the standard IMF Debt Sustainability Analysis undertaken in the context of surveillance and the use of Fund resources. Views expressed in the report are those of IMF staff and do not represent those of the IMF's Executive Board.

The note sets out staff's views on a feasible macroeconomic framework that could underpin a debt restructuring operation that would restore debt sustainability with high probability. Given that the authorities are in the process of elaborating the precise content of their policy agenda, the feasible macroeconomic framework is anchored around the authorities' broad policy announcements and predicated on staff's view that a set of policies could be fully developed and implemented to render the macroeconomic framework achievable. However, there are important downside risks to the feasible macroeconomic framework, especially if the adverse global and domestic economic effects of the fast-moving COVID-19 pandemic are larger and more prolonged than assumed in this note.

The note also presents staff's view on manageable levels of gross financing needs (GFNs) and debt service denominated in foreign currency in the medium-to-long run. This enables a quantification of the envelope of debt relief on foreign-currency denominated debt that would deliver these targets, while also implying a declining debt-to-GDP ratio to manageable levels with high likelihood, conditional on the feasible macroeconomic framework and policy assumptions, and under alternative assumptions about post-restructuring borrowing conditions.

This note has no implications—and is not intended to signal any implications—for future Fund financing for Argentina. Such financing would need to be negotiated with IMF staff and management on the basis of the situation as it exists at the time of those discussions, and would also need to be approved by the IMF's Executive Board.

# CONTENTS

**TECHNICAL NOTE ON PUBLIC DEBT SUSTAINABILITY** **3**

A. Background 3

B. Coverage of Public Debt 5

C. Restoring Debt Sustainability: Conceptual Framework and Targets 6

D. Feasible Macroeconomic Scenario 9

E. Illustrative Financing and Debt Scenarios 12

F. GFN Stress Tests and Prospects for Debt Stabilization 14

G. Risks 16

**BOX**

1. Comparing Fiscal Adjustment Path with Past Restructurings 17

**FIGURES**

1. EMBI Sovereign Spread 3
2. GFNs in Restructuring Cases, 2002–18 8
3. Selected EMDEs: Exports to GDP, 2017 8
4. Selected EMDEs: Domestic Bank Assets, 2017 8
5. Cumulative Change in Primary Balance in Restructurings 10
6. Public Debt-to-GDP, 2019–2030 by Scenario 13
7. GFN-to-GDP, 2020–2030 by Scenario 13
8. Sensitivity Analysis of GFNs and Debt Under Different Scenarios 15

**TABLES**

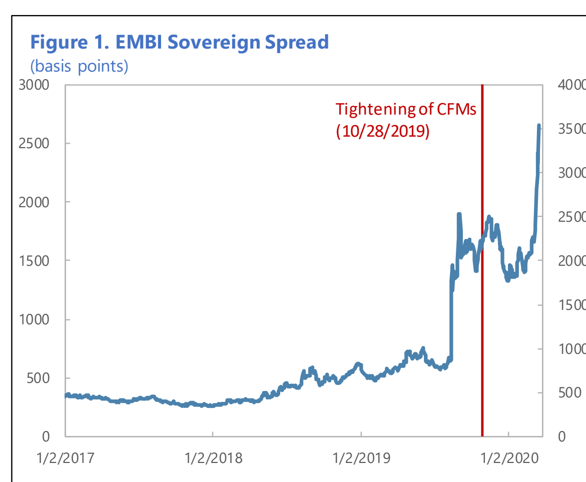
1. Public Debt and Debt Service, 2019–24 6
2. Feasible Macroeconomic Scenario 18

# TECHNICAL NOTE ON PUBLIC DEBT SUSTAINABILITY[1]

## A. Background

**1. Argentina's public debt is unsustainable**. As noted in the IMF Staff Statement of February 19, 2020, Argentina's debt and debt service capacity have deteriorated decidedly compared to the IMF's last Debt Sustainability Analysis (DSA) published in July 2019, in the context of the Fourth Review under the Stand-By Arrangement (SBA). At that time, the IMF assessed Argentina's public debt to be sustainable, but not with high probability, given downside risks resulting from: (i) the vulnerability of the public debt trajectory to a further weakening of the exchange rate, as a large share of debt was denominated in foreign currency; (ii) heightened rollover risks due to the increasingly short maturities of new issuances; and (iii) large external financing needs, often a predictor of external crises. Subsequently, those risks materialized. Since July 2019, the peso has depreciated by over 40 percent, sovereign spreads have risen by over 2700 basis points (Figure 1), net international reserves fell by half, and real GDP contracted more than previously anticipated. As a result, gross public debt rose to nearly 90 percent of GDP at end-2019, 13 percentage points higher than projected at the time of the Fourth Review. In addition, as market access became severely curtailed, Argentina unilaterally extended maturities on some of its domestic-law debt and adopted capital flow management measures (CFMs) to stabilize the currency and stem the reserve loss, which have fallen to precarious levels and now represent less than 50 percent of the IMF's Assessing Reserve Adequacy (ARA) metric.

Figure 1. EMBI Sovereign Spread
(basis points)




**2. The new government, which assumed office in December 2019, is taking steps to address Argentina's difficult debt situation**. Legislation was adopted to give the executive the power to negotiate a debt restructuring[2] and an ambitious timetable was announced to guide negotiations with private creditors. The authorities have indicated that they are seeking a collaborative solution with private creditors that would restore debt sustainability and achieve high participation. To this end, the authorities have remained current on their foreign-law debt service obligations, as well as on their domestic-law peso (AR$) debt, opting only to unilaterally reprofile maturing domestic-law FX T-bills and a dual-currency bond. The authorities have appointed financial and legal advisors to support the debt operation, and envisage presenting an offer to creditors soon, with a view to complete the operation shortly after to avoid a further

[1] This technical note is based on economic data, financial market developments, and policy announcements as of March 15, 2020.

[2] The "Management of Sustainable External Public Debt" Law approved in February 2020 provides the executive with powers to execute liability management operations, a debt exchange, and restructuring of interest and amortization payments of foreign-law debt.

drain on international reserves. Against this background, the authorities requested that Fund staff provide its view on the envelope of debt relief that could underpin a restructuring operation consistent with restoring debt sustainability with high probability.

**3. In this context, and given the desirability of quickly resolving Argentina's debt situation in an orderly manner, this technical note sets out Fund staff's views on a feasible macroeconomic framework and the envelope of debt relief needed to restore debt sustainability with high probability**.

- The note develops staff's view on a feasible medium-term macroeconomic framework that could underpin a restructuring operation that would restore debt sustainability with high probability. Given that the authorities are in the process of elaborating the precise content of their policy agenda, the feasible macroeconomic framework is anchored around the authorities' broad policy announcements and predicated on staff's view that a set of policies could be fully developed and implemented to render the macroeconomic framework achievable. As such, this note is different from the Fund's Debt Sustainability Assessment in the context of Article IV consultations or use of Fund resources, where a set of fully articulated policies underpins a baseline macroeconomic scenario.

- The note also presents staff's view on manageable levels of gross financing needs (GFNs)[3] in Argentina and provides the envelope of debt relief from private creditors that would deliver these targets and imply a declining debt-to-GDP ratio with high likelihood, conditional on the feasible macroeconomic framework, policy assumptions, and alternative assumptions about post-restructuring borrowing conditions.[4]

**4. Staff's feasible macroeconomic framework—which has been prepared at a time of exceptional global economic and financial uncertainty—is subject to important caveats.**

- *Exceptional uncertainty*. This note has been prepared at a time of significant global economic and financial uncertainty on account of the COVID-19 pandemic. Economic conditions are rapidly worsening, and financial conditions are characterized by very high volatility. This greatly increases the uncertainty about the macroeconomic framework, with potential implications for staff's assessment of debt sustainability.

- *Downside risks (see Section G for more details)***.** The key near-term risk is the possibility of a much larger and prolonged adverse global and domestic economic effects of the COVID-19 pandemic. Moreover, while the framework is based on a conservative set of macroeconomic assumptions, it hinges critically on the steadfast implementation of the assumed policy agenda, including the

[3] Gross financing needs of the government in any year are defined as the sum of the primary fiscal deficit, the debt service (i.e. sum of principal and interest payments) falling due in that year, and any outlays to meet contingent liability materializations and/or building government financial assets.

[4] While staff encourages constructive negotiations with creditors, it does not involve itself in the process or modalities of the restructuring, which is entirely the purview of the authorities and their legal and financial advisors.

ability to contain wage and price pressures and secure the consolidation of public finances. Furthermore, it assumes an orderly debt restructuring operation, which avoids a default or the failure of the restructuring to achieve sufficiently high participation. The realization of one or all of these downside risks would have important adverse implications for economic activity, the external and public financing gaps, the debt-to-GDP ratio, and GFNs presented in this note.

- *Framework caveats*. The feasible macroeconomic framework represents staff's views at this time. It has *not* been agreed with the Argentine authorities. Any future staff analysis of Argentina's macroeconomic and debt outlook would need to reexamine the macroeconomic framework on the basis of the economic situation, as well as past and prospective policies. This would likely have implications for staff's assessment of debt sustainability.

## B. Coverage of Public Debt

**5. Federal government debt reached US$323 billion at end-2019, equivalent to 88 percent of GDP (Table 1).** This overall debt can be decomposed into debt held by the IMF (US$44 billion or 14 percent of total), other official creditors (US$29 billion or 9 percent of total), private creditors (US$133 billion, or 41 percent total), and by other public sector bodies (US$117 billion, 36 percent of total), comprising debt held by the central bank (*BCRA*) and the social security trust fund (*Fondo de Garantia de Sustentabilidad*). Private sector creditors can be divided into those holding foreign-law debt (US$73 billion), which in turn includes eligible debt issued prior to 2016 (US$28 billion) and after (US$41 billion), and those holding domestic-law debt (US$60 billion; US$24 billion of which is denominated in foreign currency). Nonresidents are estimated to hold about 60 percent of all debt held by private creditors (US$80 billion), including most of the foreign-law debt and about 30 percent of all domestic-law debt.

**6. Debt service obligations to official and private sector creditors in 2020 (and beyond) will give rise to very large gross financing needs (GFNs) (Table 1).** The estimated debt service in 2020 (US$49 billion), includes payments to the IMF (US$1.6 billion) and other official creditors (US$5.2 billion), private creditors holding foreign-law debt (US$5.1 billion), private creditors holding domestic-law FX-denominated debt (US$10.6 billion) and creditors holding local currency debt (US$26.4 billion). Together, these imply gross financing needs of 13.3 percent of GDP, of which 6.1 percent of GDP is in foreign currency, beyond Argentina's ability to generate financing sources. FX debt service obligations based on originally contracted terms would remain large—exceeding US$30 billion annually during 2022–23.

**7. To analyze debt sustainability, this technical note takes as a starting point federal government debt owed to official and private sector at end-2019, worth US$207 billion (about 56 percent of GDP).** Federal government debt held by the *BCRA* and the *Fondo de Garantia de Sustentabilidad* is not a central aspect of this analysis, although staff recognizes that the ex-post level of overall federal government debt will be affected by how this debt is treated. For instance, any treatment of BCRA-held debt would have to consider the central bank's recapitalization needs, and the design of the recapitalization strategy (whether upfront or slowly) would, in turn, have implications for both near-term financing needs and long-term gross federal government debt levels.

**Table 1. Argentina: Public Debt and Debt Service, 2019–24**

| | Debt Stock 1/ | | | Debt Service 1/ 3/ | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Est. 2019 | | | 2020 | 2021 | Proj. 2022 | 2023 | 2024 | 2020-24 |
| | USD (Billion) | Percent of GDP | Percent of Total | USD (Billion) | | | | | |
| **Total Gross Federal Government Debt** | **323.4** | **88.0** | **100.0** | **77.4** | **44.6** | **49.7** | **45.8** | **28.7** | **246.3** |
| **Debt Held by Official and Private Creditors** | **206.5** | **56.2** | **63.9** | **48.8** | **26.0** | **34.1** | **33.4** | **15.0** | **157.3** |
| *Official Sector* | *73.4* | *20.0* | *22.7* | *6.8* | *8.4* | *21.5* | *21.6* | *7.4* | 65.7 |
| Multilateral | 68.0 | 18.5 | 21.0 | 4.2 | 7.9 | 21.1 | 21.2 | 7.0 | 61.3 |
| IMF | 44.1 | 12.0 | 13.6 | 1.6 | 5.3 | 18.8 | 19.0 | 4.8 | 49.5 |
| Other IFIs | 23.9 | 6.5 | 7.4 | 2.6 | 2.5 | 2.3 | 2.2 | 2.2 | 11.8 |
| Bilateral | 5.4 | 1.5 | 1.7 | 2.6 | 0.5 | 0.5 | 0.5 | 0.4 | 4.4 |
| Paris Club | 2.1 | 0.6 | 0.7 | 2.1 | 0.0 | 0.0 | 0.0 | 0.0 | 2.2 |
| Non-Paris Club | 3.3 | 0.9 | 1.0 | 0.5 | 0.5 | 0.4 | 0.4 | 0.4 | 2.2 |
| *Private Sector* | *133.1* | *36.2* | *41.2* | *42.0* | *17.6* | *12.5* | *11.8* | *7.6* | 91.5 |
| Foreign Law | 72.8 | 19.8 | 22.5 | 5.1 | 8.7 | 8.7 | 6.6 | 5.1 | 34.2 |
| Bonds with new contractual clauses | 41.2 | 11.2 | 12.7 | 1.6 | 1.6 | 1.6 | 1.6 | 3.0 | 9.6 |
| Bonds with old contractual clauses | 27.8 | 7.6 | 8.6 | 3.0 | 6.9 | 6.9 | 4.9 | 2.0 | 23.7 |
| Other 2/ | 3.7 | 1.0 | 1.2 | 0.4 | 0.2 | 0.2 | 0.1 | 0.1 | 0.9 |
| Domestic Law | 60.3 | 16.4 | 18.7 | 37.0 | 8.9 | 3.9 | 5.2 | 2.5 | 57.3 |
| FX denominated | 23.8 | 6.5 | 7.4 | 10.6 | 2.1 | 1.9 | 2.7 | 1.9 | 19.1 |
| Bonds | 10.1 | 2.8 | 3.1 | 4.3 | 1.6 | 1.5 | 2.3 | 1.5 | 11.1 |
| Tbills | 3.9 | 1.1 | 1.2 | 3.9 | - | - | - | - | 3.9 |
| Other 2/ | 9.8 | 2.7 | 3.0 | 2.4 | 0.4 | 0.4 | 0.4 | 0.4 | 4.1 |
| ARS denominated | 36.5 | 9.9 | 11.3 | 26.4 | 6.8 | 1.9 | 2.5 | 0.6 | 38.2 |
| Bonds | 16.0 | 4.3 | 4.9 | 11.1 | 3.5 | 1.4 | 1.7 | 0.4 | 18.1 |
| Tbills | 7.1 | 1.9 | 2.2 | 7.1 | - | - | - | - | 7.1 |
| Other 2/ | 13.5 | 3.7 | 4.2 | 8.2 | 3.3 | 0.6 | 0.8 | 0.2 | 13.0 |
| **Debt Held by the Public Sector** | **116.9** | **31.8** | **36.1** | **28.6** | **18.6** | **15.7** | **12.4** | **13.7** | **89.0** |
| ***Memorandum items:*** | | | | | | | | | |
| FX-Denominated Debt | 170.0 | 46.2 | 52.6 | 22.4 | 19.1 | 32.1 | 31.0 | 14.4 | 119.0 |
| Debt held by private sector nonresidents | 79.5 | 21.6 | 24.6 | 15.8 | 10.6 | 9.4 | 8.6 | 5.2 | 49.6 |
| Provincial Debt | 20.6 | 5.6 | ... | 2.4 | 3.1 | 2.5 | 3.0 | 2.4 | 13.4 |

Source: Argentine authorities and staff estimates. Data are still preliminary and subject to minor change.

1/ Based on end-2019 exchange rate of 59.9 ARS/USD. Debt-to-GDP ratio presented is based on average GDP for 2019.
2/ Includes debt not included in the exchange offer (based on Decrees 1735/04 y 563/10).
3/ On originally contracted terms.

## C. Restoring Debt Sustainability: Conceptual Framework and Targets

8. **Restoring public debt sustainability with high probability requires that Argentina's public debt and GFNs be lowered to levels consistent with the country's ability to durably service its debt.**[5] The IMF Executive Board-approved definition of public debt sustainability captures the concept of debt stabilization and the need to ensure that rollover needs are manageable over the medium-to-long term. Importantly, any such assessment needs to be grounded in an economically and politically feasible

[5] The IMF Executive Board has approved the following definition of public debt sustainability: "Public debt can be regarded as sustainable when the primary balance needed to at least stabilize debt under both the baseline and realistic shock scenarios is economically and politically feasible, such that the level of debt is consistent with an acceptably low rollover risk and with preserving potential growth at a satisfactory level." (Staff Guidance Note for Public Debt Sustainability Analysis In Market-Access Countries, 2013, https://www.imf.org/external/np/pp/eng/2013/050913.pdf).

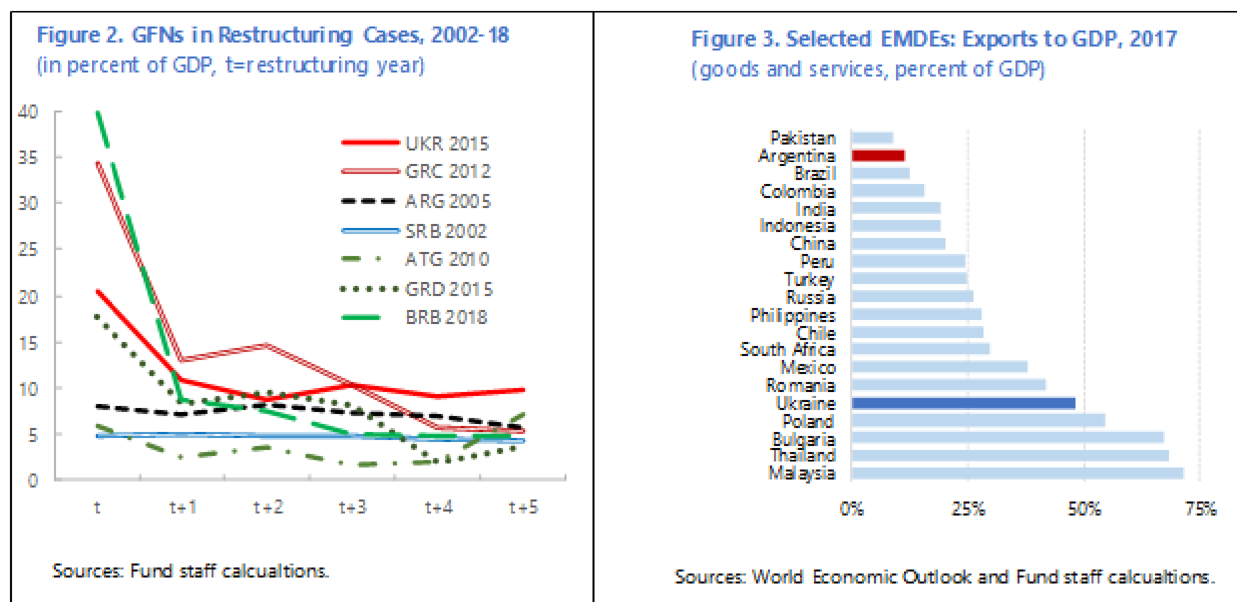
macroeconomic framework, while taking account of uncertainty, particularly when assessing whether these criteria are met "with high probability".[6]

**9. Analyzing debt sustainability requires a feasible macroeconomic framework.** The levels of debt and financing needs that can be sustained over the medium-to-long term depend critically on the outlook for growth, real exchange rates, and the primary balance (this is set out in Section D). In addition, they depend on the terms at which the government will be able to refinance its debt after the debt restructuring. Since there is significant uncertainty about these terms, this note considers several scenarios on post-restructuring financing (Section E).

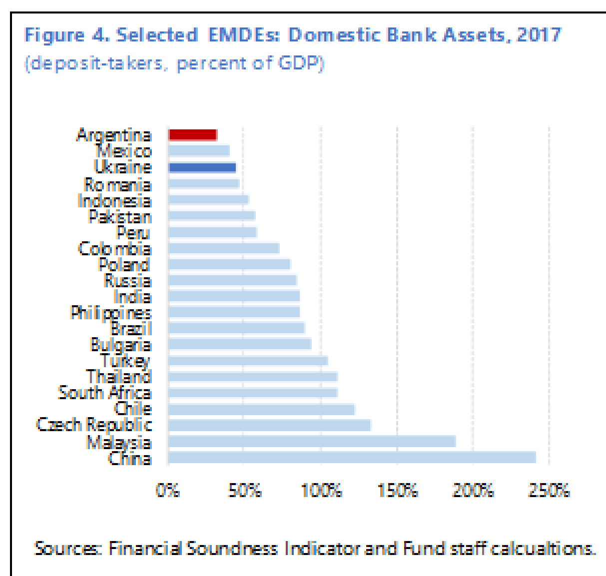
**10. Conditional on these macroeconomic and financing projections, a debt restructuring is deemed to result in a sustainable debt position if it stabilizes the country's debt to GDP ratio with an acceptably low rollover risk**. The latter is deemed to be the case if post-restructuring GFNs are sufficiently low. Following the approach taken in recent restructurings cases (notably, Greece and Ukraine), the first step in the analysis is to establish a medium-to-long-term GFN target that is appropriate given the country's debt structure and the depth of domestic financial markets. This defines a minimum cash-flow debt relief for the period 2020-30. The terms of the debt operation that deliver this minimum cash-flow debt relief must be such that the debt-to-GDP ratio declines between 2020 and 2030 with high likelihood.

**11. Recent debt restructuring cases provide some guidance as to the appropriate level of medium-to-long-term GFNs.** In a post-restructuring context, the targeted level of GFNs tends to be below what would be considered "safe" outside of a restructuring, given the need to avoid reliance on rapid market re-access. Consistent with this, in seven major restructurings since 2005, projected medium-term GFNs averaged 5.8 percent of GDP and peaked at an average of 7.6 percent of GDP (Figure 2). While some restructurings supported by IMF arrangements (e.g., Ukraine 2015) have tolerated higher GFN targets, this was in the context of important mitigating factors not present in Argentina, including large access to official bilateral support; and a stronger export base relative to Argentina's, which is exceptionally narrow and volatile (Figure 3).

[6] In the current context, uncertainty encompasses both historical uncertainty with regard to the main debt drivers and potential rollover shocks, as well as exceptional uncertainty arising from the ongoing COVID-19 pandemic. In this note, historical uncertainty is addressed through stress tests and fan charts tailored to Argentina (see Section F). Uncertainty arising from the COVID-19 pandemic is discussed in qualitative terms in Section G.




**12. A GFN target for Argentina must take into account country-specific factors, including the structure of its debt and size of its domestic investor base**. Specifically, the GFN target would need to account for the fact that Argentina's domestic banking system is noticeably small as a share of GDP relative to those of other emerging economies (Figure 4). The path for GFNs could, therefore, be derived that would ensure that Argentina's domestic banking system would, as the residual financier, be in a position to absorb the borrowing requirements created by adverse, but plausible, shocks. In calibrating these adverse shocks, account needs to be taken of Argentina's debt structure and financing outlook, the eventual return to international capital markets and—in that context—the renewed possibility of a rollover shock. An analysis along these lines (see Section F for details) suggests that it would be appropriate to target:




- GFNs averaging no more than 5 percent of GDP after 2024, and not exceeding 6 percent of GDP in any year.
- Debt service in foreign currency averaging no more than 3 percent of GDP after 2024.

A debt service profile consistent with the above-mentioned targets would improve Argentina's resilience to future liquidity shocks of a magnitude similar to those it has faced in the past.

**13. In addition to satisfying the above GFN targets, any debt restructuring operation should also stabilize debt with high likelihood over the medium-to-long term**. Given the assumed macroeconomic framework and financing scenarios, staff analysis suggests that, for a range of definitive debt restructuring operations, the minimum cash-flow debt relief required to satisfy the GFN and FX debt service targets also implies a downward trajectory of the debt-to-GDP ratio with high likelihood (see Section F).[7] Furthermore, plausible debt operations achieving this debt relief should be able to stabilize Argentina's debt below 40 percent of GDP well beyond 2030. This benchmark debt level would also create reasonable buffers relative to the average level of debt from which past Argentine defaults have begun (around 45 percent of GDP)[8], and would imply bringing the FX debt to exports ratio to about 130 percent, within the range realized following recent major restructurings.

**14. It is worth emphasizing that the GFN, FX debt service and debt targets above exclude debt held by the BCRA and by FGS, as noted in ¶7.** Including these obligations would result in an upward adjustment of these targets: for instance, the 2030 debt-to-GDP ratio (including BCRA and FGS-held debt) would be under 60 percent of GDP.

## D. Feasible Macroeconomic Scenario

**15. The Argentine authorities have announced the broad contours of their macroeconomic policy plans, while also adopting measures to secure stability**. Their strategy envisages a gradual disinflation and fiscal consolidation that preserves external balance, through a competitive real exchange rate and efforts to boost exports. The near-term focus has centered on stabilizing the economy while protecting the most vulnerable segments of the population. Taxes have been raised on exports, personal assets and foreign-currency purchases (expected to yield 1.2 percent of GDP in 2020). These additional revenues have financed an expansion of social protection programs, most notably a new nutrition program (*Tarjeta alimentaria*) which is expected to cover over 2 million poor mothers with infants. Meanwhile, in an effort to break inflation inertia, utility and public transport tariffs have been temporarily frozen, and discussions on a social pact are underway to coordinate wage and price adjustments to enable a disinflation process. A strategy to deal with the fast-moving spread of the COVID-19 pandemic is being deployed, involving containment measures and increased budgetary resources to support health services and economic activity.

**16. However, the authorities are still in the process of fully developing their policy agenda.** The precise measures that will underpin the planned disinflation, the improvement in the primary fiscal balance, and the sustained trade surplus are still being elaborated. For example, a 2020 budget has not been presented to Congress, as uncertainties remain over the debt restructuring operation (which will affect debt service), as well as over the new pension indexation formula and utility price adjustment mechanism (both of which are expected to be determined by end-June). Similarly, preparations are ongoing on a revenue

[7] Debt to GDP is computed by dividing total end-year debt expressed in pesos (with FX debt converted at end-year exchange rates) by nominal peso GDP—evaluated at the average GDP deflator—that year.

[8] This is not an unreasonable buffer given the potential size of contingent liabilities in Argentina that could arise from provincial governments and public pension-related court cases against the government.

mobilization plan and a new energy law to encourage foreign direct investment in Argentina, although precise details and timetables are still under discussion (see below).

**17. Against this backdrop, staff has formulated a macroeconomic framework which it considers to be feasible.** The framework envisages a moderate economic recovery, after the adverse and temporary effects of the COVID-19 pandemic dissipate, alongside a gradual disinflation process, and a gradual but realistic fiscal consolidation over the medium term (see Table 2). Staff's framework is not underpinned by a fully articulated set of policies. Instead, it assumes that a combination of policies, anchored around the authorities' broad announcements, could be developed and implemented that would render the framework achievable.

**18. Staff's feasible macroeconomic framework contains the following key assumptions**:

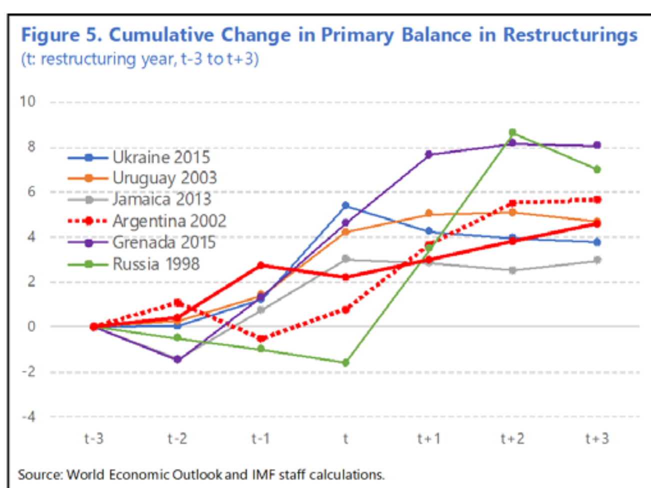
- **Growth.** Staff estimates potential real GDP growth at 1½ percent, in line with Argentina's average real GDP growth over the past 20 years. Real GDP, after contracting by 2.3 percent in 2020, is projected to gradually start recovering in early 2021, as the adverse effects of COVID-19 pandemic begin to wane. The recovery will be driven initially by a pickup in external demand and domestic consumption (supported by some recovery in real wages and transfers) followed by a gradual shift towards investment as debt restructuring uncertainty dissipates and public capital spending expands.

- **REER and trade balance.** After a modest appreciation in the near term, the REER remains near current levels to support the maintenance of a trade surplus over the medium term. Export volumes are projected to pickup in 2021 and then stabilize near historical rates (2-3 percent) after 2020, while imports volumes move in tandem with domestic demand growth and FDI.

- **Inflation.** Inflation is assumed to fall gradually underpinned by reduced monetary financing of the budget, positive real interest rates, and a rate of crawl of the nominal exchange rate which is also consistent with ensuring that the real effective exchange rate does not become overvalued. In the initial years, the disinflation is supported by incomes policies.

- **Primary fiscal balance.** Staff projects a primary fiscal deficit of 1.6 percent of GDP in 2020, on account of weaker economic activity and initial measures to deal with the adverse effects of the COVID-19 pandemic, followed by gradual and steady improvement to reach a primary surplus of 0.8 percent of GDP by 2023. In staff's view, this pace of fiscal consolidation is feasible, as well as necessary to limit monetary financing (primary deficits for 2020–21 are financed by the central bank) and ensure

**Figure 5. Cumulative Change in Primary Balance in Restructurings**
(t: restructuring year, t-3 to t+3)




Source: World Economic Outlook and IMF staff calculations.

a trade surplus. The assumed gradual fiscal consolidation would also be broadly consistent with that of past debt restructurings (Figure 5 and Box 1), after considering the adjustment since 2017. Staff's framework assumes a continued (but slower) improvement in the primary balance after 2023 to reach a medium-term level of 1.3 percent of GDP starting in 2025. That said, in the event the adverse effects of the COVID-19 pandemic are deeper and more prolonged, the feasibility of staff's fiscal consolidation path may need to be revisited (see Section G).

- **International reserves.** Staff assumes a steady and gradual increase in international reserves—supported by a trade surplus and modest FDI inflows—to strengthen Argentina's resilience to shocks, in the context of a gradual easing of CFMs and an eventual access to international markets. This would also allow for a gradual strengthening of the BCRA's balance sheet, which would put it in a stronger position to meet its price stability mandate. Staff projections imply that reserve coverage could increase to over 70 percent of the ARA metric over the medium term, although a further buildup of international reserves is desirable as opportunities arise and conditions allow.

**19. Staff's feasible macroeconomic framework is underpinned by the following assumptions about macroeconomic policies:**

- **Fiscal policy.** Staff assumes that feasible fiscal consolidation of about 2½ percent of GDP over 2021-23, can be achieved through a combination of revenue and spending measures.
  - ✓ On the *revenue front*, beyond the changes introduced in the Emergency Law and the assumed cyclical recovery (1.5 percent of GDP), the framework assumes that a domestic revenue mobilization plan could be designed to boost federal revenues by about 1 percent of GDP.
  - ✓ On the *spending front*, the overall primary spending to GDP envelope is assumed to remain relatively unchanged as a share GDP, with a rebalancing of spending toward growth-enhancing human capital and infrastructure spending.
- **Monetary policy and disinflation strategy.** Staff assumes that official exchange rate acts as the de-facto nominal anchor to meet the disinflation goals, with incomes policy playing a supportive role in the near term. The framework assumes that a social agreement with unions and employers is reached that helps to break the backward indexation of wages, and that the temporary price controls are gradually lifted starting the second half of 2020.
- **Capital controls.** Staff assumes that capital controls remain in place in the medium term, although some gradual unwinding is envisaged, especially to encourage FDI.
- **Policies to support growth.** Staff assumes efforts are made to encourage exports and incentivize FDI, including in Argentina's vast shale oil and gas reserves of *Vaca Muerta*.

**20. The trade and primary fiscal surpluses implied by this macroeconomic framework are far from sufficient to meet Argentina's contractual debt service obligations.** The cash-flows from the assumed macroeconomic framework over the next five years are insufficient to cover FX interest obligations on existing debt to the private sector (about US$25billion calculated at the contractual terms),

and principal repayments on FX debt owed to private creditors (about US$45billion) cannot be refinanced at rates consistent with debt sustainability (see Table 1). Staff is of the view that higher trade and primary balance surplus would not be economically and politically feasible. As such, a definitive operation that generates sufficient cash-flow debt relief over the medium term, as well as the necessary reduction in the debt-to-GDP ratio, will be required to restore debt sustainability with high probability.

## E. Illustrative Financing and Debt Scenarios

**21. In addition to the path of macroeconomic variables, Argentina's debt relief needs depend on the financing terms on which it can meet its obligations to official creditors during 2021–24 (US$66 billion)**. The more onerous the terms of this new financing (the higher the interest rate and the shorter the maturities), the higher the debt relief needed to meet the medium-to-long-term GFN and debt targets. In contrast, if this financing is raised at less onerous terms, the required debt relief from the operation may be smaller. The terms of this new financing are especially relevant for medium-term GFNs, as shorter maturities impose high rollover requirements soon after the restructuring, at a time when market access may still be fragile.

**22. To illustrate the uncertainty associated with near-to-medium term financing, three scenarios were designed for the terms at which the Argentine government could borrow during 2021–24.[9]** In all three scenarios, new FX borrowing during 2021-24 is assumed to be sufficient to meet obligations to official creditors.

- ***Scenario 1***. Average interest rate of 9 percent and a maturity of 3 years.
- ***Scenario 2***. Average interest rate of 7 percent and a maturity of 5 years.
- ***Scenario 3***. Average interest rate of 5 percent and a maturity of 7 years.

All scenarios assume that the authorities will be able to finance new FX obligations coming due *after* 2024 on the same terms.

**23. Given these financing scenarios, reaching the overall GFN and FX debt service targets set out in ¶12 requires the following *minimum* FX cash-flow debt relief—the difference between pre- and post-restructuring FX debt service to private creditors—over 2020-30**. [10]

- ***Under Scenario 1 (S1),*** US$80-85 billion.
- ***Under Scenario 2 (S2),*** US$70-75 billion.
- ***Under Scenario 3 (S3),*** US$50-55 billion.

[9] These financing scenarios are purely illustrative and do not represent the views of the IMF Executive Board.

[10] Achieving broadly similar overall GFN targets across scenarios would also require different treatment of domestic peso-denominated debt, with the longest maturities and lowest interest rates needed in scenario 1, followed by scenario 2.

**24. There are many combinations of debt restructuring parameters—face value haircuts, maturity extensions, grace periods, and interest rate cuts—that could deliver the requisite minimum cash-flow debt relief while also ensuring a falling debt-to-GDP ratio (Figures 6 and 7).** Choosing these parameters is an issue for the authorities and their private creditors. That said, and consistent with ¶20, the analysis shows that there is virtually no scope for FX debt service payments to private creditors during 2020–24. Furthermore, the final calibration of these the debt restructuring parameters would, of course, also need to ensure that, after 2030, the debt-to-GDP ratio remains broadly stable and GFNs remain manageable.

**Figure 6. Public Debt-to-GDP, 2019–2030 by Scenario**

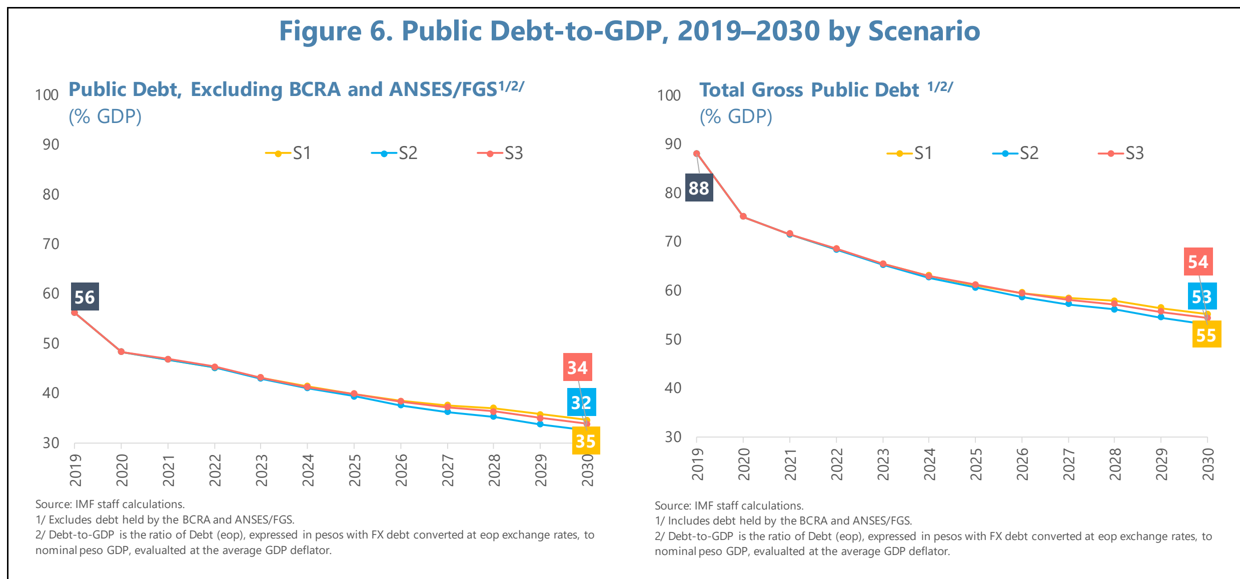
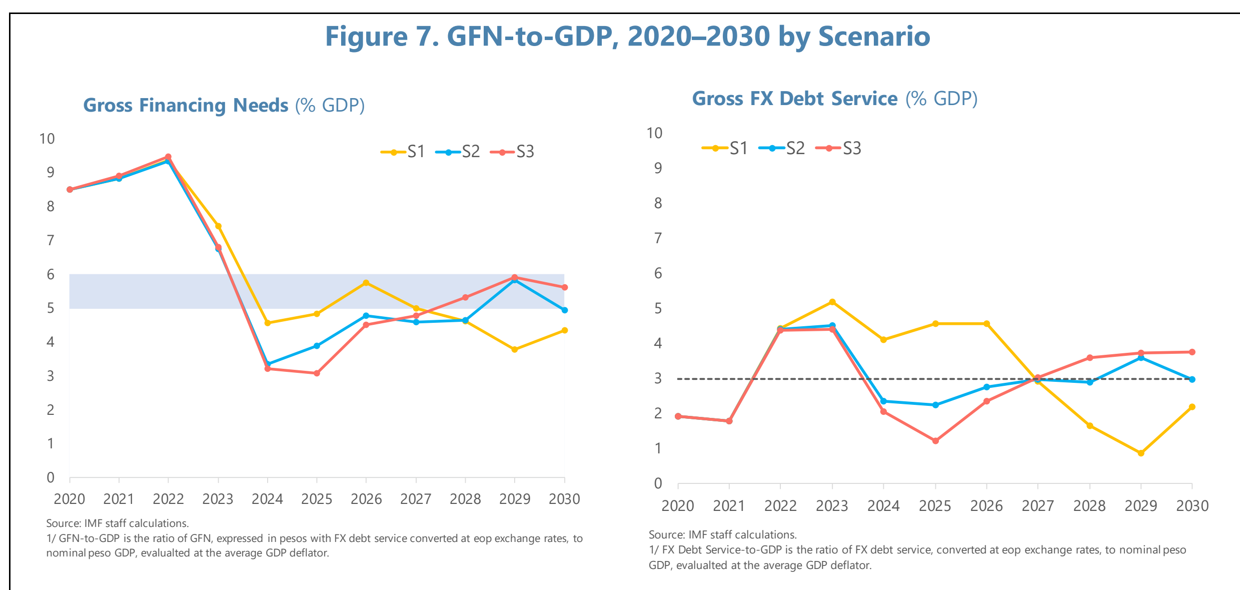



**Figure 7. GFN-to-GDP, 2020–2030 by Scenario**



## F. GFN Stress Tests and Prospects for Debt Stabilization

**25. Staff subjected the illustrative GFN paths associated with each of the three scenarios to a stress test which combines adverse macro, fiscal, and financing shocks to determine if Argentina would be able to withstand a renewed bout of liquidity pressures (similar to the 2018–19 episode)**.

- *Design of the stress test*: The stress test is applied in the latter part of the projection horizon (2026-27) and combines weaker economic growth, higher exchange rate depreciation, higher interest rates and shorter maturities on newly issued debt. As a result, annual GFNs under stress are higher over 2026-30, by around 3-4 percent of GDP on average (Figure 8, left panel). A rollover shock is then superimposed based on the assumption that foreign private creditors do not finance any new borrowing needs of the government and only partially roll over maturing debt.[11]
- *Implications*: Given the stress calibration, the maximum manageable GFN level is defined as the maximum level for which the *implied financing needed from the domestic banking system* (which is the residual financing source) is manageable.[12] Staff's view on this implied financing is that it should remain below 2 percent of GDP (on average), or 10 percent of Argentine banking system assets (blue bars in Figure 8, left panel). The manageable GFN level for the post 2024 period implied by this analysis is an average of 5 percent of GDP and not exceeding 6 percent of GDP in any year (see ¶12). Moreover, within this GFN target, FX debt service would need to average around 3 percent of GDP to contain the impact of exchange rate volatility in the stress scenario. Staff's analysis suggests that levels materially above these benchmarks could prove challenging to manage, notwithstanding sound macroeconomic and debt management policies.

**26. Additionally, staff examined the prospects for debt stabilization in Argentina, accounting for the historical uncertainty around the main debt drivers**.[13] Operationally, this was done using 10,000 draws of shocks to growth, primary balances, real exchange rates, and interest rates and using them to simulate fan charts centered on the debt paths in scenarios 1, 2, and 3 (Figure 8, right panel). It is then possible to infer the probability of debt stabilizing in each path, by calculating the share of simulated debt trajectories for which the projected primary balance exceeds the debt stabilizing primary balance. As can be seen, the probabilities of debt stabilization are high, around 90 percent, in all three scenarios.

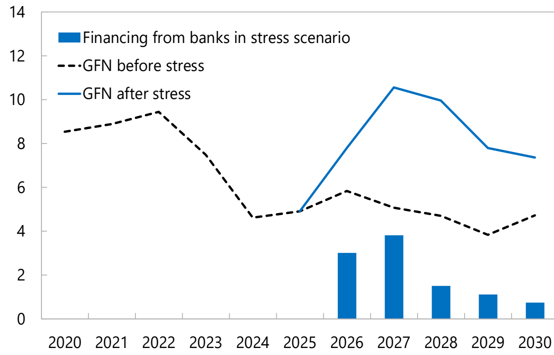
[11] Specifically, it is assumed that, in 2026 and 2027 the foreign private creditors' rollover rate is 67 percent; it then recovers to 100 percent after that, but these creditors still do not finance the primary deficit.

[12] See Arslanalp and Tsuda (2014), for example, for explanations regarding domestic bank exposures to the sovereign can rise in a stress situation.

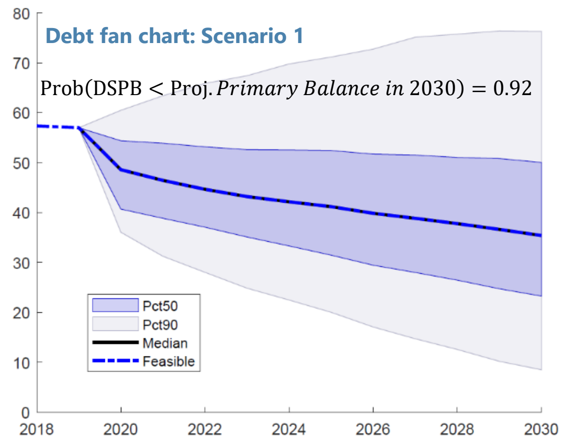
[13] Historical uncertainty may not capture the possible extraordinarily large adverse effects from the COVID-19 pandemic.

## Figure 8. Sensitivity Analysis of GFNs and Debt Under Different Scenarios

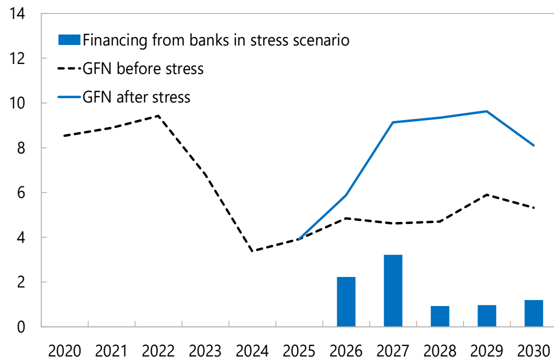
### GFN projections: Scenario 1
(in percent of GDP)



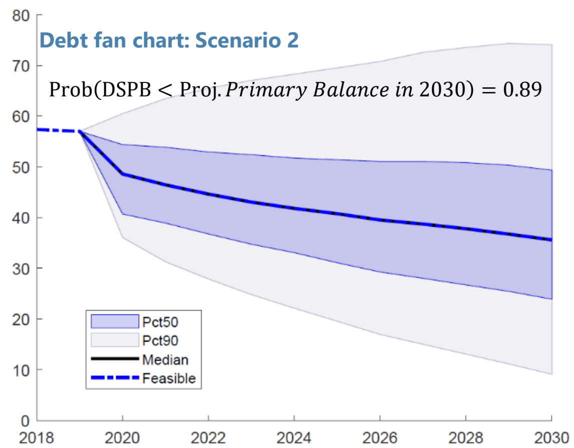

Source: Fund staff estimates



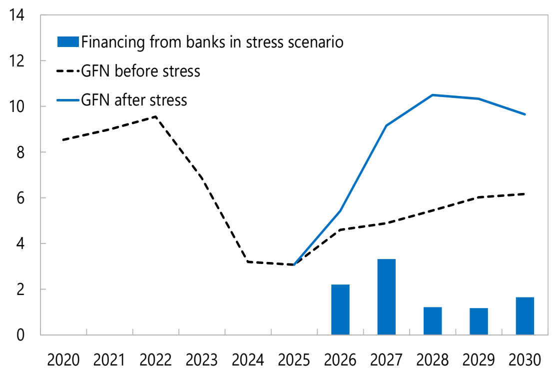

### GFN projections: Scenario 2
(in percent of GDP)



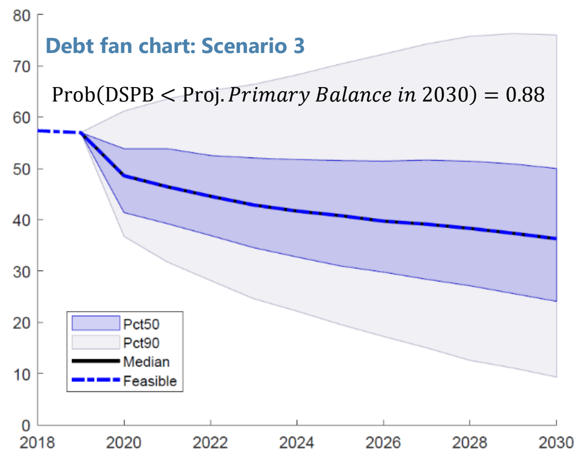

Source: Fund staff estimates




### GFN projections: Scenario 3
(in percent of GDP)




Source: Fund staff estimates



## G. Risks

**27. Staff's macroeconomic framework has been developed at a time of exceptional global economic and financial uncertainty and is therefore subject to important downside risks**.

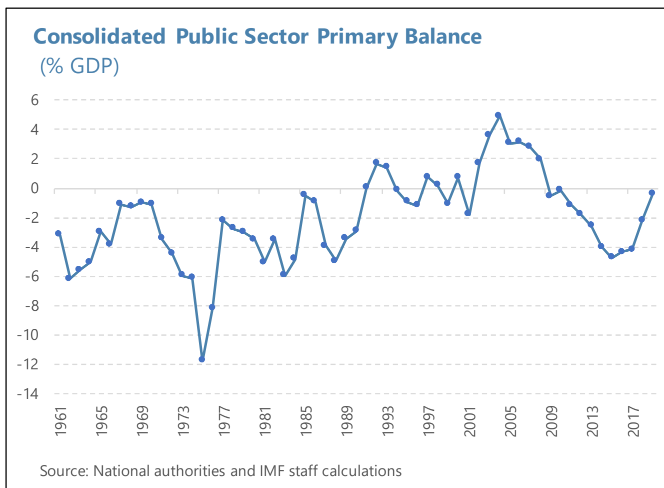
- The key near-term risk relates to a stronger-than-projected negative impact of the COVID-19 pandemic, which could more adversely affect Argentina than currently assumed, through an even stronger and more prolonged decline of external demand and commodity prices, as well as even weaker domestic activity. Argentina's fiscal accounts would worsen even more—both on account of lower growth but also on the need to increase spending on health and programs to support economic activity. Although the strict CFMs provide a measure of stability, Argentina will not be immune from the tightening of global financial conditions and strict financing constraints would constrain its ability to properly address the shock.
- Staff's framework hinges critically on the steadfast implementation of the assumed policy agenda. The inability to contain wage, pension and other spending pressures, including those coming from the provinces, or insufficient revenue mobilization could jeopardize the projected fiscal consolidation starting in 2021 and lead to sizably larger monetary financing needs, which in turn, would hurt the disinflation process and effectiveness of CFMs. Meanwhile, the absence of reforms to boost exports and growth could undermine Argentina's ability to sustain growth, maintain external balance, and rebuild international reserves.
- The realization of contingent liabilities—including those related to provincial debt—could adversely affect Argentina's debt path.
- Lastly, staff's framework assumes that a sustainable debt deal with high creditor participation is achieved. Failure to reach such a deal could have serious implications for economic and financial stability in Argentina.

**28. Significant materialization of these risks would require a reassessment of Argentina's macroeconomic situation, policies, and, possibly, debt-bearing capacity**.

## Box 1. Comparing Fiscal Adjustment Path with Past Restructurings

**The fiscal consolidation path in this analysis is ambitious.**

- First, it is similar to that of other sizable restructurings, especially after considering the fiscal *effort* in the years leading up to the restructuring. Argentina would be projected to move from a primary deficit of 3.8 percent of GDP in 2017, to a surplus of 0.8 percent in 2023 (Figure 5). This would put Argentina's projected fiscal effort in line with those of past restructuring cases, recognizing that in some past cases, namely Russia 1998 and Argentina 2002, the fiscal effort began in earnest after the operation.

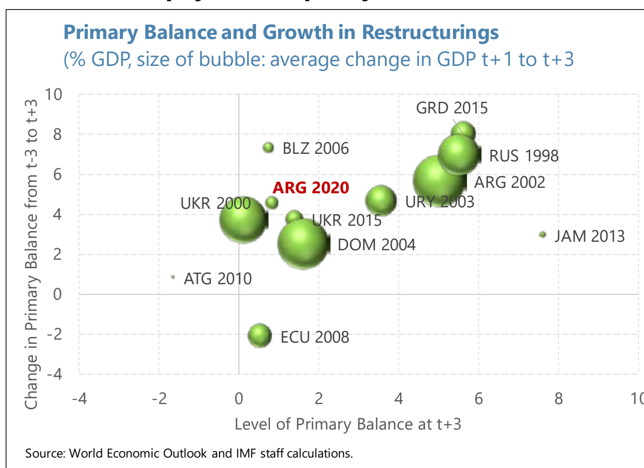



- In addition, while the projected medium-term *level* of the primary fiscal balance would be on the lower end of past restructurings, it would nonetheless be in stark contrast to Argentina's own fiscal history. It is worth noting that Argentina achieved a primary fiscal surplus in only 9 out of the past 57 years, most of which coincided with the early 2000s commodity boom (see text figure).

**A commitment to fiscal consolidation and sustained primary surpluses will put the economy on stronger long-term footing and enhance Argentina's debt repayment capacity.**

The proposed primary surpluses are projected to contribute about 10 percent of GDP toward debt dynamics between 2022 and 2030.

Moreover, restoring debt sustainability with high probability will help to put Argentina on a more solid and sustainable growth path. Past restructurings have been associated with important expansion of economic activity, although there is no clear relationship between the size of the fiscal adjustment and the growth outcomes, as these likely reflect other factors, including the overall success of the debt operation and other economic policies (see text figure).



## Table 2. Argentina: Feasible Macroeconomic Scenario

| | | Est. | | | | | | Proj. | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 |
| Real GDP (percent change) | -2.4 | -2.1 | -2.3 | 2.2 | 2.2 | 2.1 | 2.0 | 1.7 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 |
| Primary fiscal balance (percent of GDP) 1/ | -3.5 | -1.1 | -1.6 | -0.8 | 0.0 | 0.8 | 1.1 | 1.3 | 1.3 | 1.3 | 1.3 | 1.3 | 1.3 |
| Trade Balance (percent of GDP) | -1.8 | 3.0 | 3.5 | 2.7 | 2.5 | 2.0 | 1.5 | 1.3 | 1.3 | 1.3 | 1.3 | 1.3 | 1.3 |
| REER (percent change, eop, + = appreciation) | -28.3 | -4.7 | 5.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Base money (percent of GDP) | 9.3 | 7.7 | 7.7 | 7.7 | 7.7 | 7.7 | 7.7 | 7.7 | 7.7 | 7.7 | 7.7 | 7.7 | 7.7 |
| **Memo item** | | | | | | | | | | | | | |
| GDP (US$ billions) 2/ | 538 | 450 | 450 | 482 | 504 | 526 | 548 | 570 | 591 | 611 | 633 | 655 | 678 |
| Gross reserves (percent of IMF ARA metric) 3/ | 62.9 | 46.8 | 50.6 | 52.5 | 55.5 | 59.1 | 60.9 | 62.7 | 63.9 | 66.1 | 68.1 | 70.1 | 72.0 |

Source: National authorities and IMF staff calculations and projections.

1/ Federal government. Excludes proceeds from FGS asset sales, BCRA profit transfers booked above the line in 2018, and other one-off measures.

2/ Based on average period GDP and exchange rate.

3/ Estimates based on the IMF's Assessing Reserve Adequacy (ARA) methodology (https://www.imf.org/external/np/pp/eng/2014/121914.pdf)