<u>DEBT SUSTAINABILITY GUIDELINES</u>

Argentina's public debt is on an unsustainable path: the refinancing cost of its debt has become implausibly high. While this was already the case before the global Covid-19 outbreak, the ongoing pandemic has made the situation even worse. An adjustment of the terms of our public debt is therefore necessary, with the eligible debt to be restructured standing at USD 83 billion. This is only a portion of total government debt, but putting this debt on a sustainable path will be a key milestone in the resolution of Argentina's debt crisis. The government intends to apply the below principles across all foreign currency-denominated eligible debt, whether issued under local or foreign law.

Our policy objective is to bring public debt back to sustainable levels, consistent with:

(i) prospects of sustainable growth for the economy;
(ii) a plausible fiscal trajectory over the short and long run;
(iii) prudent expectations on future refinancing costs;
(iv) reasonable assumptions about Argentina's future engagement with the International Monetary Fund ("IMF").

The overarching principles of our policy are:

(i) to put debt on a sustainable path. This implies fostering a downward debt-to-GDP trajectory stabilizing over the long term, consistent with a fiscal and trade balance paths supporting a sustained economic recovery. We aim at reaching this objective by structurally lowering the cost of funding;
(ii) to allow the Argentine economy to absorb the shocks of the financial crisis of the past year and the ongoing Covid-19 crisis;
(iii) to generate sufficient buffers against future exogenous shocks.

In its debt sustainability framework, the government will not include debt held by public entities such as the BCRA and FGS/ANSES, since these entities are consolidated with the overall national public sector.

The appendix summarizes our assumptions regarding the key parameters underlying our debt sustainability analysis.

<u>Design principles</u>

Our policy aims at ensuring debt sustainability with high probability under our assumptions. This must also be compatible with IMF's assumptions factoring in a potential new program with Argentina. This entails the following principles:

1) Grace period

Given the balance of payments constraints, and Argentina's incapacity to return to international credit markets in the near future, a substantial grace period on foreign currency debt is required. This grace period is essential for the years to come to open the necessary space to allow for Argentina's real activity to recover after the series of shocks the economy has been going through.

Given uncertainties in the short term, it is imperative to replenish reserves of the Central Bank that will enable the Argentine economy to absorb exogenous shocks. Our plan is to reach USD 65 billion of foreign exchange reserves by 2024. A further build-up of reserves until 2030 is contemplated to a level of USD 77 billion. Such foreign exchange reserves increase will allow for an orderly easing of capital account regulations.

2) Reduction of coupons

In order to restore the country's ability to pay its interest bills on an ongoing and sustainable basis (without simply rolling debt over on international credit markets), coupons for the medium- to long-term must be reduced substantially.

3) Cap on foreign currency debt service capacity

Regarding the debt service at large, taking into account the low export base of Argentina's economy and bearing in mind the time it will take to ease capital account regulations and develop local capital markets in Argentina, we must limit foreign currency debt service to reasonable levels over the medium- to long-term.

Therefore, we are considering maturity extensions and/or possible reductions in the nominal face value of the eligible debt to attain an amortization profile with refinancing costs that permit the economy to cope with adverse shocks.

4) *Value recovery mechanism*

The government is considering various options for contingent value recovery mechanisms that would allow for potential upsides, should a more positive economic scenario than the baseline envisaged under government's assumptions materialize.

5) Refinancing cost and exit yield

The sustainability of our debt is linked to our medium-to-long run refinancing costs, in particular in the international credit markets. As such, the reference exit yield embedded in any potential debt operation will need to be consistent with the refinancing cost embedded in our debt sustainability framework; any excessively high reference exit yield suggests the need for a stronger combination of lower coupons, longer grace periods, longer maturity extensions, or larger reductions in nominal face values.

Technical appendix

Debt Perimeter

The perimeter of eligible public debt excludes the debt held by the following public institutions:

- BCRA (USD 81.9bn of debt as at end-2019, of which USD 15.3bn in form of FX market debt);
- FGS (USD 35.0bn, of which USD 14.9bn in form of FX market debt);
- ANSES (USD 0.1bn, no holding of FX market debt).

Macroeconomic Assumptions

	Unit	2019	2020*	2021*	2022	2023	2024	2025	2026	2027	2028	2029	2030
Real GDP Growth													
Upper bound	%		(1.0%)	3.0%	2.5%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
Lower bound	%		(1.5%)	2.5%	2.0%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%
Primary Balance													
Upper bound	% of GDP		(1.1%)	(0.5%)	(0.0%)	0.5%	0.7%	0.9%	1.1%	1.2%	1.2%	1.2%	1.2%
Lower bound	% of GDP		(1.5%)	(0.9%)	(0.4%)	0.1%	0.3%	0.5%	0.7%	0.8%	0.8%	0.8%	0.8%
Trade Balance													
Upper bound	% of GDP		3.8%	2.8%	2.3%	2.1%	2.0%	1.9%	1.9%	1.9%	1.9%	1.9%	1.9%
Lower bound	% of GDP		3.4%	2.4%	1.9%	1.7%	1.5%	1.4%	1.4%	1.4%	1.4%	1.4%	1.4%
Gross Reserves													
Upper bound	USD bn		50	54	58	62	65	67	70	72	74	75	77
Foreign exchange rate													
Real exchange rate assumed to be constant													

* The scenarios have been carried out before the Covid-19 outbreak. At this point, we are assuming that uncertainty about economic activity and fiscal balance during the initial years will not affect medium-to-long term scenarios for debt sustainability assessments.

Funding Assumptions

<u>International Financial Institutions ("IFIs") debt</u>:

- We have been engaging constructively with the IMF and it is our intention to seek a new program that will allow the existing IMF loan to be refinanced until Argentina can access international debt markets at sustainable rates.
- The principal repayments on IFIs (excluding the IMF) debt are assumed to be perpetually refinanced at their current average nominal interest rate.

<u>Short-term debt in pesos:</u>

- The stock of short-term debt in pesos is assumed to remain constant in nominal USD terms.

- This debt is assumed to be refinanced annually at 1.2% to 1.5% in real terms.

New medium-to-long-term funding mix assumptions:

- From 2027 onwards, gross financing needs are assumed to start to be financed under the following mix: 40% by new Peso denominated debt and 60% by new foreign currency debt.
- We intend to reduce foreign currency debt in favor of local currency debt in line with the development of the domestic debt capital market.

Foreign currency denominated debt medium-to-long-term funding assumptions from 2027 onwards:

- New medium-to-long-term foreign currency denominated debt is assumed to be financed at an average interest rate of 5% in real terms until 2034, and 4.5% from 2035 onwards.
- New medium-to-long-term foreign currency funding is assumed to be performed ratably through 3 market debt instruments with respective average maturity of 5, 10 and 15 years (each instrument amortizing in 3 equal annual installments).

Peso denominated debt medium-to-long-term funding assumptions:

- Peso-denominated debt is assumed to be financed through different CER-linked instruments across the curve.

ECONOMIC PROGRAM GUIDELINES

POLICY STRATEGY

The economic program aims at addressing Argentina's macroeconomic challenges. The program relies on a pragmatic and flexible approach, taking into consideration the country's binding constraints. Economic policy is guided by the overarching objective of establishing a sustained trend of economic growth and, on that basis, address the social ills that have been afflicting the country. That implies breaking the recurrent pattern of stops and goes, booms and busts, illusions and broken promises that have so painfully characterized Argentina. The consequent process of lengthening decision horizons, public and private, must necessarily bridge a transition, starting from a present state where attentions are focused on the very immediate future, as the economy was already in the midst of a crisis when hit by the global shock. From a policy point of view that implies managing flexibly immediate urgencies as they arise in this uncertain context, while keeping a longer-term perspective. The policy approach recognizes the requirement to attend to the ultimately complementary demands for macroeconomic stabilization, productive development, especially regarding the supply of internationally traded goods, and social inclusiveness, while dealing with the tradeoffs that will arise along the way. Flexibility with a clear longer-run purpose will also be the criterion here.

By achieving clear and realistic policy objectives, we will provide a stable macroeconomic environment that would in turn enable longer-term investments and sustained growth.

Ongoing developments related to the Covid-19 outbreak highlight the importance of policy flexibility in the face of an uncertain world.

MACROECONOMIC SCENARIOS

The macroeconomic scenarios that we have calibrated reflect the necessary conditions for a sound economic recovery, factoring in appropriate buffers to address any further domestic or external shocks. These scenarios also reflect what the government considers socially supportable.

i. A steady-state real growth rate between 1.5 percent and 2 percent, preceded by a first initial phase of recovery with higher growth rates related to the post-recession excess capacity.

ii. The growth scenarios are consistent with a trend of growth in exports corresponding to a trade balance in the range of 1.4 percent to 1.9 percent of GDP in the medium term. We consider this trend a realistic goal, consistent with the proposed stable macroeconomic environment.

iii. This scenario proposes a gradual fiscal consolidation from a primary deficit of 1 percent of GDP in 2019 excluding extraordinary income, reaching a primary balance between 2022 and 2023, and up to a surplus in the range of 0.8 percent to 1.2 percent of GDP in the medium term. This is compatible with a shift in the composition of expenditures toward greater public investment as well as higher fiscal revenue. The steady-state primary balance is consistent with the parameters of economic recovery.

iv. The Covid-19 outbreak will critically impact the economy, notably owing to the "social distancing" measures put in place across the globe, including in Argentina. Measures to address the Covid-19 crisis have been adopted in line with international standards and aim at protecting the most vulnerable factions of the population and economic sectors. Estimates of the Covid-19 impact on the economy are still in preparation.

ECONOMIC POLICY

The contemplated policy measures are part of a comprehensive program aiming at ensuring a recovery of the economic activity and employment, resolving imbalances and providing support to the most vulnerable. It relies on the following three pillars: (i) strengthening the social safety net; (ii) provide an orderly resolution to the debt crisis and (iii) establish a fiscal consolidation path compatible with a disinflation process.

The Social Solidarity and Production Reactivation Law ("Solidarity Law", hereafter), approved in December 2019, provides a wide range of economic and social reforms. It declared a state of public emergency, which will remain in force until December 31, 2020, in economic, financial, fiscal, administrative, pensions, tariff, energy, health, and social matters. It sanctioned the delegation of certain legislative powers to the Executive Branch in order to tackle social and economic distress, as well as to adjust Argentina's public debt profile.

Strengthening the social safety net

From December 2019, a set of policies was put in place to strengthen transfer programs for lower-income population and avoid an increase in unemployment in the most vulnerable sectors in the labor market.

Provide an orderly resolution to the debt crisis

i. The government has passed a set of key legislative tools to resolve the debt situation in an orderly way: (i) the "Solidarity Law" authorized the Executive Branch to perform all necessary acts to recover and ensure the sustainability of Argentina's public debt; and (ii) the "Debt Sustainability Bill" authorized the government to engage with Argentina's creditors to restore the sustainability of its external public debt, based on the principles of good faith, transparency, and equal treatment.

ii. The Government was also authorized to issue debt securities to the Central Bank for an amount of up to U.S.$ 4.571 billion in exchange for reserves to be used to service Argentina's foreign currency-denominated debt obligations.

iii. In the last days of January 2020, the Ministry of Economy published a timeline of actions to manage the process of restoring the sustainability of external public debt.

iv. At the beginning of March, the restructuring perimeter of the private debt in foreign currency was defined by decree and the Ministry of Economy was authorized to carry out the necessary debt operations to resolve the current situation.

v. On peso-denominated debt, the Government has made significant progress since December 2019. The new administration started to issue short-term bills (the so called "Lebads") linked to the BADLAR rate, enabling the government to roll over peso debt at sustainable rates while lengthening maturities. In that regards, the government has successfully swapped approximately USD 5 bn of peso-denominated debt. These operations reduced the outstanding peso-denominated obligations for 2020 with private sector from USD 19 bn to USD 12.4 bn (decrease of 35%). Additionally, interest rates decreased sharply in primary debt issues from 73.55% in July 2019 (the last peso-denominated instruments issue carried out by the previous administration) to 35% in March 2020.

vi. IMF Staff members visited Argentina twice and exchanged views with the Argentine authorities on their macroeconomic plans and policies. After completing the first mission, the IMF Staff publicly evaluated that Argentina's public debt is not sustainable and that actions are required to re-establish sustainability with high probability.

vii. After completing the second mission and at the request of the Argentine authorities, the IMF Staff produced and disseminated a technical report on debt sustainability analyzing the actions required to restore the sustainability of public debt with high probability. This note presented a feasible medium-term macroeconomic framework and the gross financing needs, including debt service in foreign currency that the Argentine economy can sustain in the coming years.

Fiscal consolidation path compatible with a disinflation process

i. The tax policy (including the measures embedded in the Solidarity Law) aims at contributing to fiscal sustainability by strengthening tax resources, without neglecting the objectives of equity.

ii. Progressive taxes on external transactions were strengthened. The legislation introduced the "Impuesto Para una Argentina Inclusiva y Solidaria" ("PAIS Tax") a special tax applicable to certain foreign exchange transactions. The reduction in Property Tax rates that has been in effect since 2017 was eliminated and an over-tax was introduced, taxing the holding of assets abroad, excepting those that repatriate up to 5 percent of their holdings. For the internal tax on motor vehicles, ranges were introduced for the sale price, with higher rates being imposed on high-end and luxury cars (mostly imported).

iii. Tax exemptions with high fiscal cost and low impact were eliminated or postponed. The decree eliminating VAT for certain goods was not renewed to better target this benefit, through a refund system for vulnerable sectors. The reduction in employer contributions was postponed (considering it had no effect on job creation) but favorable changes are implemented for SMEs.

iv. Tax on financial transactions was eliminated to encourage savings in pesos.

v. Measures were implemented to improve tax compliance. A Facility Plan for SMEs was established to encourage card payments. A cash withdrawal tax was also introduced.

vi. On expenditures, a review process of relevant policies was initiated. The use of the existing formula for automatic adjustments of retirements and pensions payments owed by the federal government was suspended for 180 days. The government is currently devising a new indexation formula based on the principle of shared growth and consistent with the macroeconomic framework presented by the Minister of Economy. The Solidarity Law empowers the government to establish a new formula to be used in calculating pension adjustments, following the temporary suspension.

vii. Public utility price policies are one of the tools to converge towards a sustainable disinflation path. Price-wage agreements should be consistent with competitiveness and inflation objectives. The Central Bank has been following a strategy of persistent reduction in interest rates consistent with the comprehensive macroeconomic strategy that aims at productive reactivation and a gradual and persistent disinflation.

viii. In the horizon, the goal is to reduce the inflation rate to a single digit, below 5 percent per year, and to minimize monetary financing, recovering the use of monetary policy for macroeconomic stabilization purposes. In the transition towards fiscal balance, the public sector will resort prudently and in a decreasing manner to Central Bank financing. Fostering demand for peso-denominated assets is a high priority.

ix. Capital account regulation is a necessary instrument in times of emergency. The current regulations will be to a large extent maintained in the early phase of the recovery program. The goal is to ease those regulations in an orderly way. Foreign exchange reserve accumulation targets are a necessary condition for achieving that goal.

POLICY RESPONSE TO COVID-19

Argentina took early action to contain the virus by imposing a strict lock-down. Economic policy measures taken so far entail a fiscal stimulus, whose amount will be conditional on the length and impact of the quarantine. The following measures will have an impact on the fiscal conditions.

i. Households relying on informal activities, domestic workers or self-employed that have suffered income losses will receive a one-off bonus in April. Additional conditional cash transfers to poor families include one-off bonus targeting retirees and non-contributory pension beneficiaries with minimum pensions.
ii. Public food programs are being expanded.
iii. In sectors critically affected by the lock-down such as entertainment, transport, restaurants and hotels, the government will pay part of the salaries and exempt employers from social security contributions. Unemployment insurances have been reinforced for those workers who have been dismissed without a fair cause during this period.
iv. Public banks will support private companies with subsidized credit for up to 180 days.
v. Public investment will be boosted by an increase of 40 percent in the budget allocation for capital expenditures.