

# INTERNATIONAL BULLETIN



# BNDES

*The Brazilian  
development bank*

[www.bndes.gov.br/conhecimento/publicacoes/catalogo/sinopse\\_intl.asp](http://www.bndes.gov.br/conhecimento/publicacoes/catalogo/sinopse_intl.asp)

## Nº 13 – April, 2010

### HALF-YEARLY PUBLICATION

*Team: Ana Claudia Alem, Fabrício Catermol, Rodrigo Madeira, Simone Saisse and Renan Brandão*

*Support: Amanda Pinheiro and Felipe Reina*

### 1) WORLD OUTLOOK

#### SUMMARY

World Outlook.....	1
The performance of the global economy and outlook for the coming years .....	1
Greece, the PIIGS and the future of Euro..	4
Brazil and the BRIC .....	5
The fight against unemployment .....	8
The foreign direct investments in the world	9
Recent trends .....	9
Behavior during the crisis .....	11
Box 2.1: Public policy for investment within the cope of the global crisis .....	13
Medium-term prospects .....	14
The FDI in Brazil.....	15
Brazilian foreign trade.....	15
Box 3.1: The recovery of US imports.....	21
Special Article: The Argentine economy and the recent controversy on the use of inter- national reserves .....	22
Introduction.....	22
The Argentine economy in 2009 .....	23
Argentine reserves .....	27
Conclusion .....	30

**The performance of the global economy and perspectives for the coming years .....**

The recovery process for the global economy is still underway, but, in general, it has surprised, in a good sense, economic analysts, who successively reviewed their perspectives toward a more optimistic scenario. However, this process was not the same among national economies, presenting a diversity of growth rates and social indicators. Developed countries still present controversial indicators that do not clearly translate into an improvement in the confidence of producers and consumers. In most developing countries, a clearer trend of recovery in economic activity can already be seen.

**International Synopsis is under the full responsibility of its authors and does not reflect the official opinion of the BNDES.**

Closing of the edition: April 30, 2010

E-mail: [sinopseinternacional@bndes.gov.br](mailto:sinopseinternacional@bndes.gov.br) Phone Number: 55 – 21 – 2172-7369

**Please, contact us to receive the International Synopsis directly in your e-mail.**

In April's review of the IMF's forecasts, the growth rate of the world economy in 2010 was raised by 0.3% to 4.2%. The group of developed countries is expected to grow 2.3%, while the group of developing economies will grow 6.3%. These differences in the pace of economic recovery are expected to continue in the coming years. (Table 1.1)

Table 1.1: Annual growth rate of real GDP (%)						
	2007	2008	2009	IMF's Forecasts		
				2010	2011	2015
<b>World</b>	5.2	3.0	-0.6	4.2	4.3	4.6
<b>Developed countries</b>	2.8	0.5	-3.2	2.3	2.4	2.3
<b>US</b>	2.1	0.4	-2.4	3.1	2.6	2.4
<b>Euro Zone</b>	2.8	0.6	-4.1	1.0	1.5	1.7
<b>Germany</b>	2.5	1.2	-5.0	1.2	1.7	1.2
<b>France</b>	2.3	0.3	-2.2	1.5	1.8	2.2
<b>United Kingdom</b>	2.6	0.5	-4.9	1.3	2.5	2.5
<b>Japan</b>	2.4	-1.2	-5.2	1.9	2.0	1.7
<b>Korea</b>	5.1	2.3	0.2	4.5	5.0	4.0
<b>Developing Countries</b>	8.3	6.1	2.4	6.3	6.5	6.7
<b>Brazil</b>	6.1	5.1	-0.2	5.5	4.1	4.1
<b>China</b>	13.0	9.6	8.7	10.0	9.9	9.5
<b>India</b>	9.4	7.3	5.7	8.8	8.4	8.1
<b>Russia</b>	8.1	5.6	-7.9	4.0	3.3	5.0

Source: IMF

The differences in perspectives, added to the reduced levels of interest rates in developed countries, have changed the capital flows in the world and resulted in changes in exchange rates. There was a depreciation of the dollar and an appreciation of currencies from many other countries with a floating exchange rate regime, but these changes will not be enough to correct current imbalances in the current accounts of national economies.

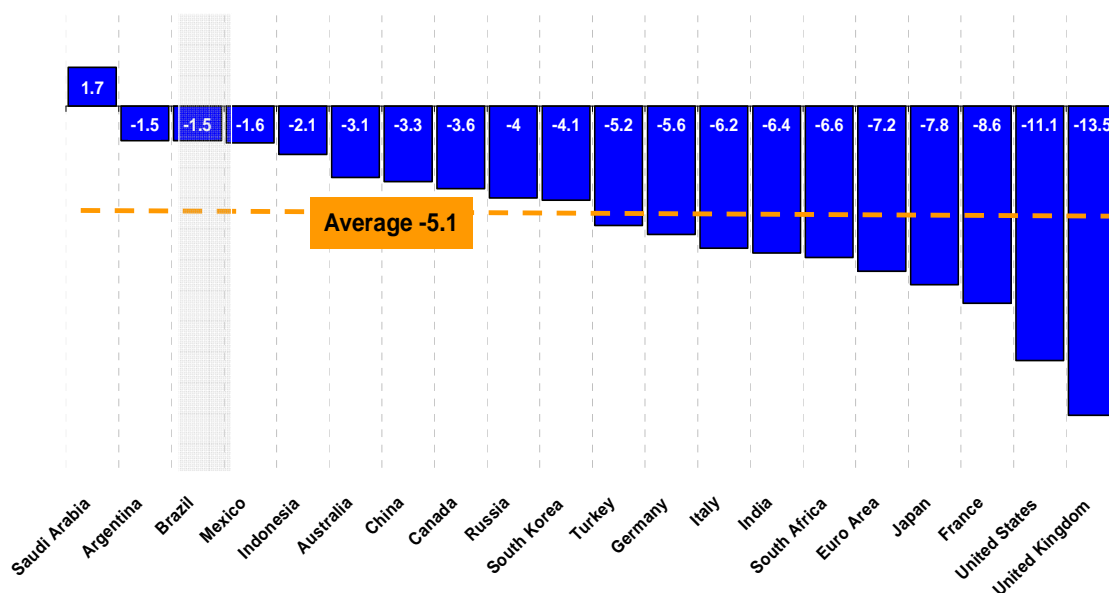
Risks to global financial stability were lessened with the deleveraging and restructuring of the balance sheets of banks and financial institutions. The main risk that currently exists is the possibility of some developed, highly indebted and less dynamic countries defaulting. The deleveraging of fund lenders, the increased aversion to risk, the maintenance of fiscal deficits and the reduction of activities themselves made the sovereign risk premium of those economies soar. The greatest difficulty they find in financing their debts reduces the leeway to maneuver in order to maintain expansionary fiscal policies in these countries, which, in turn, prevents the recovery of its dynamism. As most of the debt of these countries was taken on through the global banking system, a new systemic risk for the sector is established.

The IMF's recommendations point toward the reduction of the sovereign risk of national debt. For such, a credible medium-term strategy for fiscal con-

solidation is recommended, which is capable of reducing the debt / GDP ratio in countries with a high sovereign risk. The fiscal incentive packages may continue to stick to the planned schedule even in countries with a sizeable debt, but not in those economies whose risk premiums greatly increased. In this case, greater urgency in the fiscal and social security reforms is recommended.

In developed economies, as the pace of the economic activity has not fully responded to government incentives, and demand is still down, an expansionary monetary policy is expected to continue, coupled with the fiscal incentive schedule. In developing economies, a gradual reduction of fiscal measures has already been noted, and lower public deficits are expected in 2010 (Graph1.1). The monetary policy, which up to now has been expansionary, has already begun to diminish. In developing economies, the faster recovery and the influx of international capital justify the gradual removal of post-crisis measures, although there is no evidence of inflationary pressure or generalized price bubbles. These economies must pay attention to the excessive appreciation in their exchange rates, which may undermine the competitiveness of their economies.

Graph 1.1: Public Deficit in the World - 2010 – The Path of the Nominal Result for the Public Sector in % of GDP



Source: The Economist. Reproduced from the Ministry of Finance

### Greece, the PIIGS and the future of the Euro.....

While in the 1990s the sudden downsizing of international liquidity more severely affected indebted emerging economies, the latest global economic crisis has been more brutal in economies with higher fiscal deficits and lower competitiveness in Europe. By satirizing the consecrated acronym that represents the leading countries in world growth, namely, the BRICs, the group of European countries facing the greatest difficulties in the post-crisis has been nicknamed the PIIGS. They are: Portugal, Italy, Ireland, Greece and Spain. Of all these, Greece has been in the spotlight for being very close to moratorium and upsetting the moods on the international financial markets.

The fall in government tax collection and the need to implement a dynamic fiscal policy after the crisis made it so these countries had huge budget deficits as a proportion of GDP in 2009: 14.3% in Ireland, 13.6% in Greece, 11.2% in Spain, 9.4% in Portugal and 5.3% in Italy. The debt / GDP ratio in these countries is at very high levels: 115.8% in Italy, 115.1% in Greece, 76.8% in Portugal, 64% in Ireland and 53.2% in Spain at the end of 2009. These factors, coupled with the still poor prospects for the coming years, made sovereign risk premiums for these countries skyrocket and made the rollover of their debt a problem. According to the *Maastricht treaty*, the conditions to join the euro are: debt of up to 60% of GDP and a fiscal deficit of up to 3% of GDP.

The rating agencies lowered the ratings of these countries. On April 27, *Standard & Poor's* downgraded the ratings of Greece and Portugal. Thus, Greece lost its investment grade. On the next day, it was Spain's turn to have its debt downgraded.

One of the most significant remnants of the crisis was the high unemployment rates, which mainly concerned the central economies and, mainly, the PIIGS. In Spain, for example, unemployment reached 20.05% in the first quarter of the year, and the burst of the real estate bubble held back the civil construction sector, which is the driving-force of the Spanish economy and labor-intensive. With the free movement of European citizens, unemployment will not respect national borders. Furthermore, the drop in wages in these countries affects the export performance of the countries that lead the block.

The future of the euro depends on the recovery of the economies of the PIIGS, and, also, of the implementation of coordination instruments for economic policy that surpass the limits of monetary policy. If there is any encouraging aspect in the PIIGS' economic situation, it must be that not only will these countries and the IMF strive to recover the health of these economies, but all nations that depend on the success of the euro.

### Brazil and the BRICs

The acronym BRIC, created by Jim O'Neill of *Goldman Sachs*, was initially aimed at grouping countries for purposes of investment analysis. Over time, the term started to be incorporated into a wide array of environments and actually brought the nations referred to in the acronym closer together. The question that comes up repeatedly is whether these countries actually constitute an economic block. The April 15 edition of *The Economist* featured an article entitled "*The trillion-dollar club*", which addresses this issue.

The characteristics that bring these countries closer are roughly the same that protected them against the perverse effects of the recent global economic crisis: the developing economies with an annual GDP exceeding 1 trillion dollars, which has been growing at high rates in recent years, are jointly accountable for about 15% of world exports, receive close to 15% of direct foreign investments, and have international reserves of approximately 40% of the world's reserves, which served as a liquidity cushion against the possible post-crisis flight of capital. China alone has reserves of around 2.4 trillion dollars and is the world's second largest creditor, after Japan. The public debt of these countries is stable and at low levels.

These countries called attention by severing connections with an old world economic order, presenting themselves as an alternative to the Washington Consensus. All of them have a vast domestic market, adopted income transfer programs to reinforce it, are diversifying their economies, and are seeking to enhance trade with emerging nations. This strategy of reducing dependence on developed consumer markets was key in promoting a shift in the core economies at the post-crisis phase.

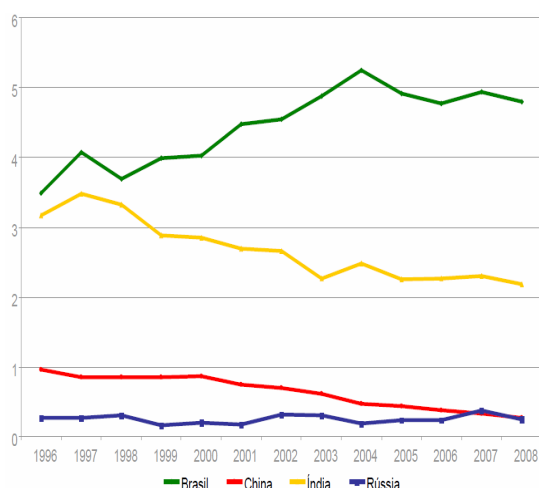
However, there are also some differences between these countries, such as: i) the structure of the political system: Two countries have political regimes with centralized power and two countries are consolidated democracies, ii) two have permanent seats on the UN's security council and the other two do not, and iii) the total population and the economically active population are expected to grow in Brazil, India and China, but fall in Russia. There have already been several territorial disputes between India and China, and disputes for influential areas in Asia. These countries have sought to expand trade among themselves, but always through bilateral negotiations, which, sometimes, impair the other BRICs. Their diplomats try to competitively establish markets and access to natural resources in African countries.

Concerning economic aspects, the *per capita* income ranges from 15,000 dollars per year in Russia to 3,000 dollars per year in India. China and Russia are the most open economies, with exports accounting for around one third of GDP, while, in Brazil and India, exports do not exceed a fifth of GDP. China and Russia have massive surpluses in their current accounts, whereas India and Brazil have recorded small deficits. The exchange rate varies from a fixed to a floating regime. China, for example, has come under international criticism for maintaining the depreciation of its currency (the *Yuan*) against the dollar.

IPEA issued a notice at the opening of the BRIC summit held in April this year in Brazil. This notice defines the export specialization standards of these countries. Using the methodology for Indexes of Revealed Comparative Advantage (IVCR), it has been noticed that (see Graphs 1.2 to 1.6):

- Brazil has a high advantage in natural resource-intensive products and agricultural and cattle-raising commodity products;
- Russia has far more competitiveness in mineral commodities;
- India has high competitiveness in labor-intensive products, but has maintained increases in competitiveness in exploring natural resources;
- China has a high advantage in the production of labor-intensive goods and was the sole country that presented high competitiveness in technology-intensive goods.

Chart 1.2: Evolution of IVCR - agricultural and cattle-raising commodity products



Graph 1.3: Evolution of IVCR - mineral commodity products

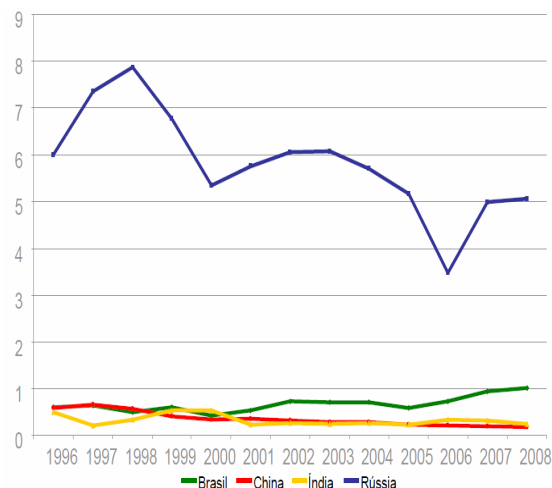


Chart 1.4: Evolution of IVCR - natural resource-intensive products

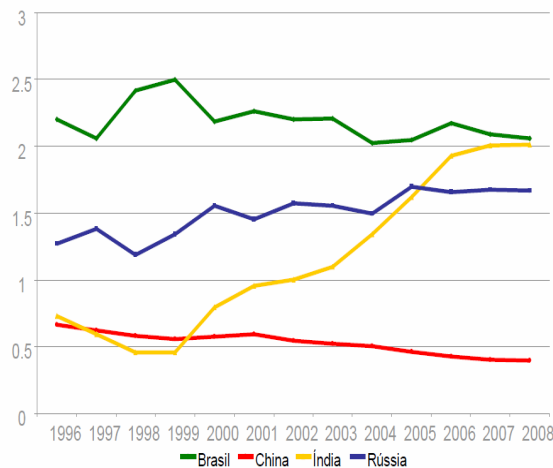


Chart 1.5: Evolution of IVCR - labor-intensive products

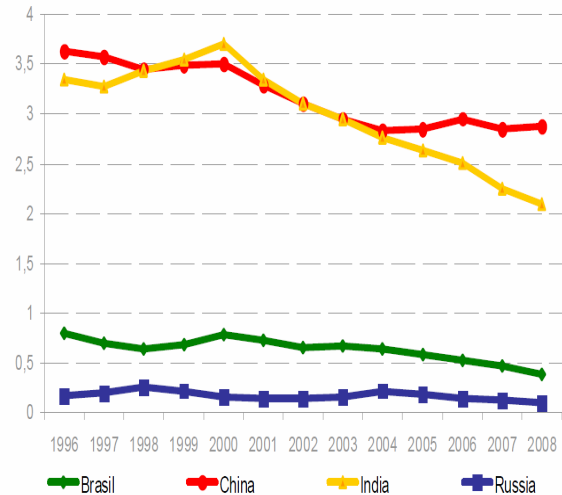
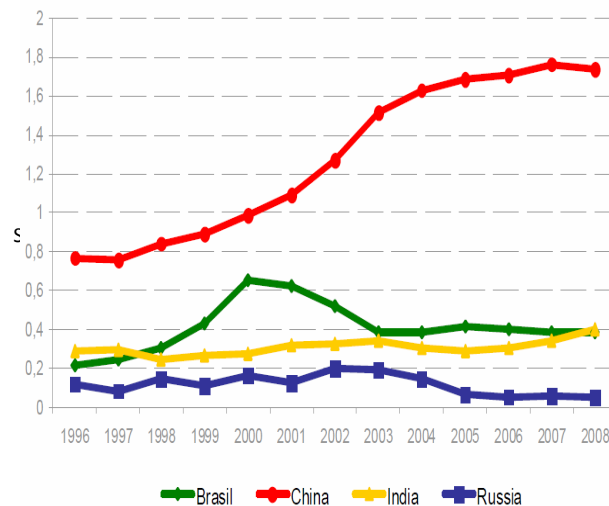


Chart 1.6: Evolution of IVCR - technology-intensive products

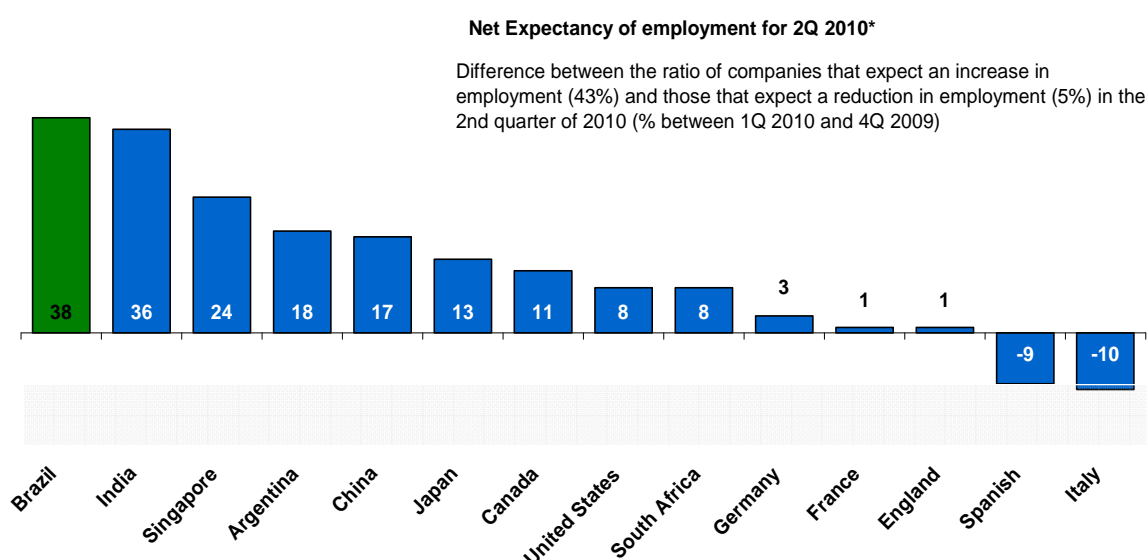


The BRIC countries do not have many historical similarities, do not share cultural aspects and are not geographically close to each other. Furthermore, they have not negotiated any multilateral trade plan as of yet. Nevertheless, these countries have such different political goals that legitimize them as a block, and they are supported by the United States in this. The economic timing allows the BRIC countries to take a shot at a new insertion into the global economy, correcting the imbalances that certainly led to the crisis and reviewing the developed countries' supervision of the world economy. The members of this new block have requested changes to their positions in multilateral bodies, such as the IMF, and have signed protocols of intention for cooperation, such as the one signed by their development banks at the summit hosted in Brazil. They have carried out debates to create a basket of currencies for transactions among the BRIC countries that could make them less dependent on dollar reserves.

## The fight against unemployment

The economic recovery underway appears to be regionally uneven. For most developed countries, a slower pace of economic recovery is expected. For these economies, the high and persistent unemployment rates have to be the main focus of the economic policies to be adopted. On the other hand, in the economies that responded well to the crisis, if there was an increase in unemployment, it was brief. In this sense, Brazil stands above the rest: a qualitative survey carried out through interviews with 850 Brazilian companies pointed toward the prospect of extensive creation of new jobs in the coming months (see Chart 1.7).

Chart 1.7: Brazil - Most substantial creation of jobs in the world



\* Manpower Employment Expectancy Survey for the 2nd quarter of 2010 by interviews carried out in a sample of 850 employers in Brazil.

Source: Manpower. Reproduction from the Ministry of Finance.

For economic theory, there is a well-established inverted connection between changes in unemployment and changes in products, translated in Okun's Law. Chapter 3 in the April 2010 edition of the *World Economic Outlook* proposed to study how financial crises, real estate bubbles, sectorial changes and the role of policies and institutions can change this inverted connection, which is, primarily, stable.

The main findings of the study were the following:



- The reaction of unemployment in relation to product increased in the last few decades, owing to institutional changes, such as protective labor laws that are less restrictive and an increased use of temporary contracts. Temporary employment increases the reaction of unemployment in relation to the crisis, but it can also accelerate the recovery of employment when the economy starts growing again. Temporary workers also receive less training in their jobs. Overcoming the dualism between temporary work and traditional registered work is recommended. This can be achieved by using contracts of an unlimited term, in which rights and labor costs progress gradually;
- Recessions, financial crises, real estate bubbles and sectorial shocks cause increases in unemployment that are higher than what is foreseen in Okun's Law. In the subsequent recovery, the creation of jobs is also slower than what is predicted by theory, due to greater macroeconomic uncertainty;
- Short-term work programs implemented after recessions are able to prevent increases in unemployment of the magnitude expected in theory;
- The creation of wage-insurance can be useful to encourage the migration of workers between declining industries and industries that thrive in crisis. The lower risk of earning less means workers are more likely to arbitrarily seek new jobs, reducing dismissal costs and stimulating employment in the economy as a whole;
- The expansionary monetary and fiscal policies are the main instrument for promoting employment in economies that have been seriously affected, where unemployment is likely to become a structural issue. The restructuring of the financial sector is also critical, since the labor-intensive sectors depend heavily on bank credit.

The still cautious predictions with regard to advanced economies returning to a more accelerated pace of activity make unemployment a legacy of the crisis that will remain for some time. The activism of public policies to increase the level of aggregate demand is key to solving this problem: accelerating growth rates in countries is the best way to reduce unemployment levels.

## 2) Foreign Direct Investments in the World

### Recent trends

Global flows of foreign direct investment (FDI), which had shown a small recovery in the second quarter of 2009, remained relatively stable over the last two quarters of the year. That is the conclusion which is taken from the behav-

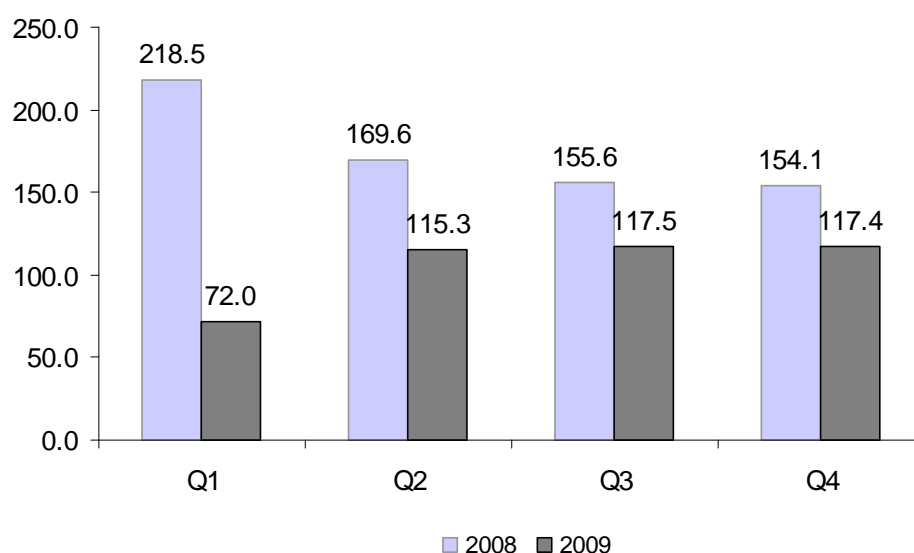
ior of the Quarterly Index of Global FDI calculated by the United Nations Conference on Trade and Development - UNCTAD.\*

After registering a historic peak in the last quarter of 2007, the UNCTAD index fell continuously until the first quarter of 2009. Growth in the second quarter and the ensuing stability show that if, on the one hand, the worst of the crisis has passed, on the other hand, global FDI has not resumed an upward path. The current level is similar to the average levels in 2006 and, roughly speaking, it is half of what was recorded in the first quarter of 2008 (Chart 2.1).

UNCTAD attributes this behavior to the fact that, in spite of the recovery of profit, transnational companies were cautious about their foreign investments, as is shown by the low amount of cross-border mergers and acquisitions and the small number of greenfield projects in the last quarter of last year.

Although the index for the first quarter of 2010 is not available yet, there are prospects for improvement, as the FDI tends to follow, albeit delayed, economic growth. However, the finding that the number of announced greenfield projects fell slightly early in the year suggests that caution is still the motto for companies' expansion projects.

Chart 2.1: FDI Quarterly Index (2005 = 100)



Source: UNCTAD

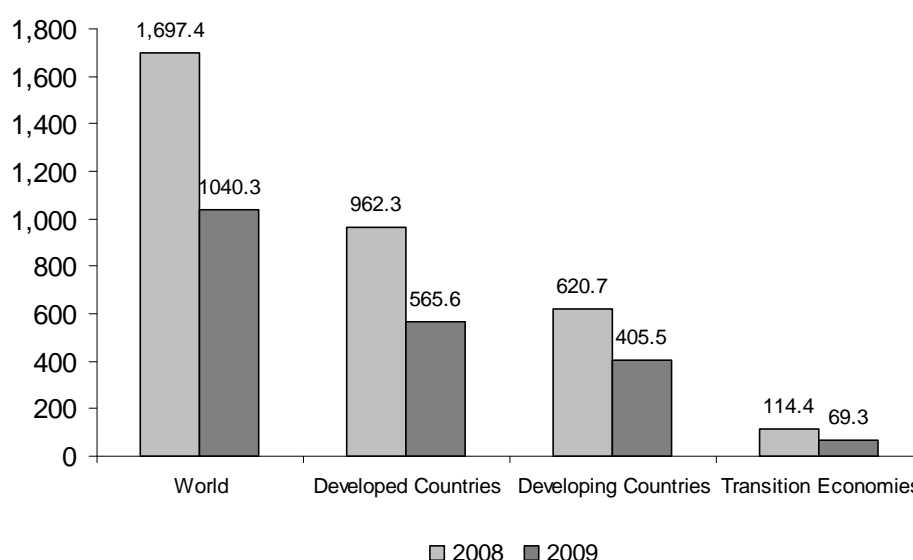
\* *UNCTAD Global Investments Trends Monitor*, Nr. 3, 26 April 2010. The index is calculated incorporating data from close to 60 countries, which account for more than 90% of the destinations of FDI in 2008.

## Behavior during the crisis

The slump in economic activity and the confidence crisis that followed the bankruptcy of Lehman Brothers in September 2008 strongly affected, as would be expected, the global FDI flows in the last two years. After five years of uninterrupted growth, from 2003 to 2007, global direct investment fell 14% in 2008 and 39% in 2009. In terms of amounts, direct investment fell from a total of approximately US\$ 2 trillion in 2007 to just over US\$ 1 trillion last year, according to the preliminary survey carried out by UNCTAD.

Unlike what was seen in 2008, when the decline in FDI was restricted to developed countries, the fall in 2009 was widespread and affected all groups of countries - developed, developing and transitional countries, with few exceptions to the general rule (Germany, Denmark and Italy in the group of developed countries, Peru, among the developing countries) (Chart 2.2). In view of this situation, several countries have adopted measures to increase the allure of their economies to foreign investment (Box 2.1).

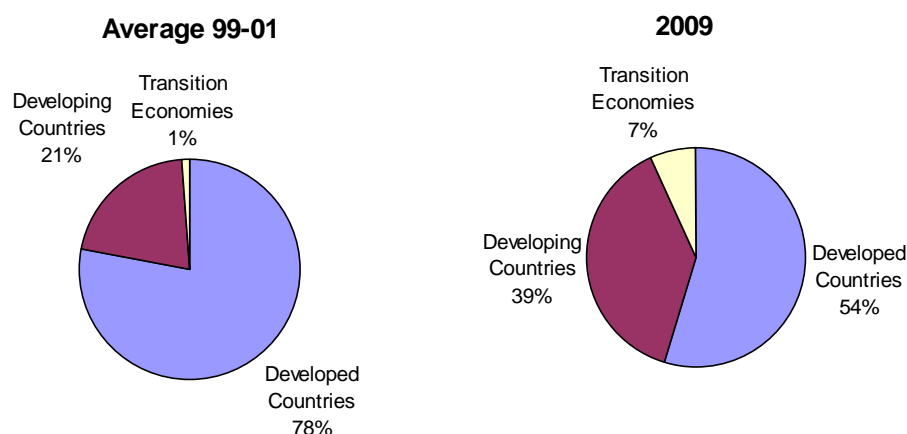
Chart 2.2: Inflow of FDI per region (USD billion)



Source: UNCTAD

The developed countries continued presenting the worst performance in relation to that of the other groups of countries. Among them, the fall in FDI in 2009 was 41%, a variation that drops to 35% for developing countries. As a result of this relative performance, it must be noted that, even though the developed group still prevails as the main destination of FDIs, in 2009 its total share fell to 54%, against an average of 74% in the early 2000s (Chart 2.3).

Chart 2.3: Destination of the FDI per country group



Source: UNCTAD

In the United States, the focal point of the crisis, FDIs fell to less than half of what they had been in the previous year (-57%); the same happened in Japan (-53%). In Europe, the fall was, on average, lower (-28%), but with significant differences between the countries, especially the reductions in the United Kingdom, Spain, France and Sweden.

Among the developing countries, the fall was significantly greater for Latin America and the Caribbean (-41%) and smaller for Asia and Oceania (-32%). In China, which alone received 22% of total FDIs heading to developing countries, the fall in 2009 was only 3%.

The fall in FDIs in 2009 was widespread not only concerning destinations, but also for its determining components: reinvested profits, intercompany loans and equity investments.

Reinvested profits, which usually have a more stable behavior, were compressed by the fall in profits of multinational companies late in 2008 and early in 2009. Intercompany loans also fell.

However, the most evident of all was the fall in equity investments, led by a 66% reduction in the amount of mergers and acquisitions between companies in different countries, resulting from the decline in the value of companies on stock markets and the smaller financial capacity of prospective buyers. The number of greenfield investment projects, in turn, fell 23% within the period as a result of cancelled operations and reduced business expansion programs.

**Box 2.1: Public policies for investment within the scope of the global crisis**

The financial and economic crisis of the last few years has affected not only the noticeable flows of direct investments, but also the normative framework that regulates these flows. The finding was made by UNCTAD, which, last December, launched a new publication (Investment Policy Monitor), aimed at recent development in foreign investment-focused policies.

The main conclusion of the survey was that most of the adopted changes were aimed at deregulating and promoting foreign investments. Liberalization measures included: opening previously closed sectors to foreign capital (for example, banking and air transport), reducing admission requirements, as well as simplifying and accelerating licenses and other pre-requirements. In order to promote and facilitate foreign investment in specific sectors, some of the identified measures included granting tax relief and financial support.

However, not always were the adopted measures specifically for foreign investment and only reflect the general investment incentives of emergency anticyclical policies practiced by several countries, such as tax cuts and facilitating access to credit. These emergency measures account for most of the liberalizing measures identified by UNCTAD, and the fact that they have been included in the overall result tends to overestimate the importance given to foreign investment in the regulatory changes adopted by the countries after the global crisis.

The following are the main highlights of the latest survey published in April:

- Between December 2009 and March 2010, some 62 countries changed the rules that affected foreign investments;
- Twenty-eight countries adopted specific measures for investment, most of which were aimed at deregulating, promoting and facilitating foreign investment. In the period, only three countries, all from Latin America, adopted restrictive measures on foreign investment, such as new admission requirements and limits on corporate interest.
- Three countries introduced new measures to prompt Brazilian companies to make direct investment abroad, by relaxing the requirements for approval and regulation of the exchange rate related to these activities.

→ Internationally, some 73 countries entered into 37 international investment agreements from December 2009 to March 2010, of which seven were bilateral investment treaties, twenty-three were double taxation agreements (part of the G20's efforts to extinguish tax havens) and the other seven were international agreements with investment components.

Source: UNCTAD, Investment Policy Monitor, No.2, April 20, 2010

### Medium-term perspectives

The macroeconomic environment for investments has improved gradually and consistently since the end of 2009, as shown by the successive upward revisions of estimates for global growth released by the IMF (see World Outlook in this edition of the Synopsis). From a microeconomic point of view, profits disclosed by multinational companies around the world are up since the second quarter of last year.

Jointly, these two factors are expected to lead transnational companies to favorably review their foreign investment plans for this and the following years, which should bring about growth in FDI flows.

Confirming this expectation, values in cross-border mergers and acquisitions almost doubled in the first quarter of 2010, albeit on a reduced basis for comparison. A significant number of big business (over \$ 3 billion) was carried out (such as the purchase of one of *Kraft's* US plants by the Swiss company *Nestle*, while US company *Abbot* snapped up the Belgian company *Solvay*).

UNCTAD expects, however, that recovery in 2010 will only be moderate, since there are still uncertainties as to the pace and impacts resulting from the withdrawal of emergency packages adopted during the crisis. The fall in the number of greenfield projects reinforces this expectation.

For the following years, the information available is still that published in the 2009-2011 *World Investment Prospects Survey*, according to which 45% of the 240 interviewed companies stated they were optimistic or quite optimistic about the global business environment in 2011 ( See International Synopsis, Nº. 12).

## FDI in Brazil

The impact of the economic crisis on the performance of multinational companies headquartered in Brazil resulted in a reduction of inflows of foreign direct investment in 2009.

Among the components of FDIs, the net inflows for equity interest, which is the heaviest component, fell 34%, while the fall in intercompany loans was 60% (Table 2.1).

Table 2.1: Foreign Direct Investment in Brazil (US\$ billion)

	2008	2009	Var. %
Direct Foreign Investment	45.06	25.95	-42.4
Equity	30.06	19.91	-33.8
Inter-company Loans	14.99	6.04	-59.7

Source: Brazil's Central Bank

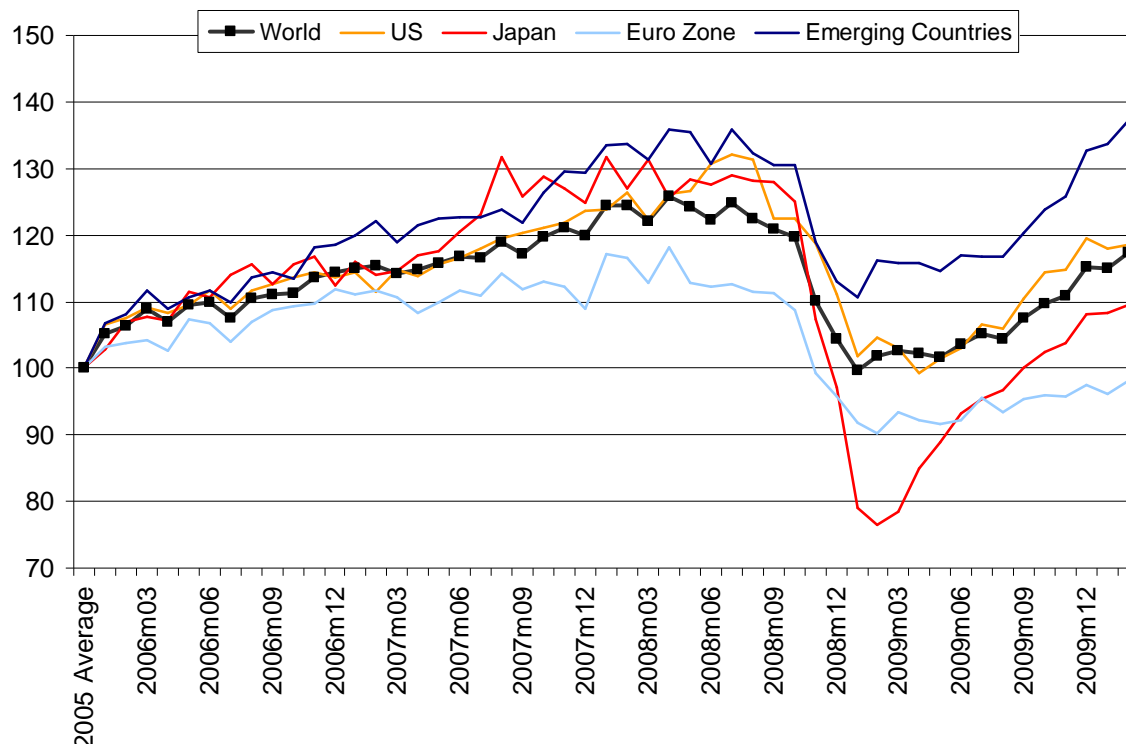
In spite of the fall, Brazil maintained its lead on the list of Latin American countries that most received foreign direct investments. Among other countries in the region, Mexico and Chile stood apart, receiving US\$ 13.0 billion and US\$ 12.9 billion, respectively.

From 2003 to 2008, FDI inflows through equity interest increased progressively. In 2009, despite the crisis, the inflow was slightly below the 2007 level. (Chart 2009) The Central Bank estimates that, in 2010, inflows will return to the same level as in 2008, i.e., to about US\$ 45 billion.

## 3) BRAZILIAN FOREIGN TRADE

In the second half of 2009, world exports presented a clear trend of recovery from the global economic crisis (see Chart 3.1). The latest available data on the monthly volume of world exports show that the volume exported in the first two months in 2010 is 15% up on the same period last year, which can be considered the lowest value in the historical series of the recent crisis. But the volume traded worldwide has not yet managed to exceed the months that immediately preceded the worsening of the international crisis which occurred as of the last quarter of 2008, and is only similar to what was seen at the end of 2006.

**Chart 3.1: World exports: 2005 to February 2010  
(2005 = 100)**



Source: Own development from data of the CPB World Trade Monitor

According to WTO projections, the world trade volume is expected to grow 9.5% in 2010, but despite being a significant value, it will not fully recuperate the 12.2% fall that occurred in 2009. In 1975, the drop was 7%, which represented the previous record.

Although heterogeneous, the current recovery is occurring in most countries, with a special focus on the group classified as emerging countries. In January 2010, exports from these countries already registered an amount similar to that posted before the worsening of the crisis at the end of the third quarter last year. Much of the recovery was due to the behavior of countries in Asia, especially China. In Latin America, although growth was not like that seen in Asian countries, the exported volume was already at levels similar to those of the end of 2007 and in early 2008.

The main developed countries performed differently over the past few months. The United States is closer to the world average for the recent rise and fall. Japan was one of the countries that posted the most severe fall in exports, but fast recovery has taken off in recent months: Japanese exports increased 35% in January 2010 in comparison to the same month last year. The countries in the Euro Zone present an experience that is quite the contrary to what has



been seen in the context of global recovery. Exports from the block remain at volumes much lower than those recorded in the phase before the crisis.

In 2009, Brazilian exports amounted to US\$ 153 billion, a total that is 23% below the previous year. The fall in Brazilian exports, in value, was equal to the world average, as can be seen in the WTO statistics. Among the main world exporters, the smallest declines occurred in China (-16%) and the so-called "newly industrialized economies" (Hong Kong, Taiwan, South Korea and Singapore; -17%). India had a slightly greater fall (-20%), but it is still below the world average of 23%. The range of US exports (-18%) followed the same trend and was lower than the world average, but the fall in Canada was more significant (-31%). The most notable reduction in the world occurred in African countries (-32%) and Russia (-36%), whose results were mainly driven by the oil trade. Exports from the European Union presented a fall equal to the world average.

Following the international behavior, Brazil also presented improvement in the first few months in 2010. After twelve months of consecutive falls in relation to the same months in the previous year, December 2009 was the first month that was up, although still modest, triggering a period of recovery. In the first three months in 2010, export values increased 26% in comparison with the same period last year. The most significant growth occurred in crude oil exports (+235%), which corresponded to an increase in absolute values of US\$ 2.6 billion in Brazilian exports. Also, other basic products and semi-manufactured goods were relevant to the recovery of the country's exports, such as chicken meat, soy meal, beef, raw sugar, pulp and the steel industry.

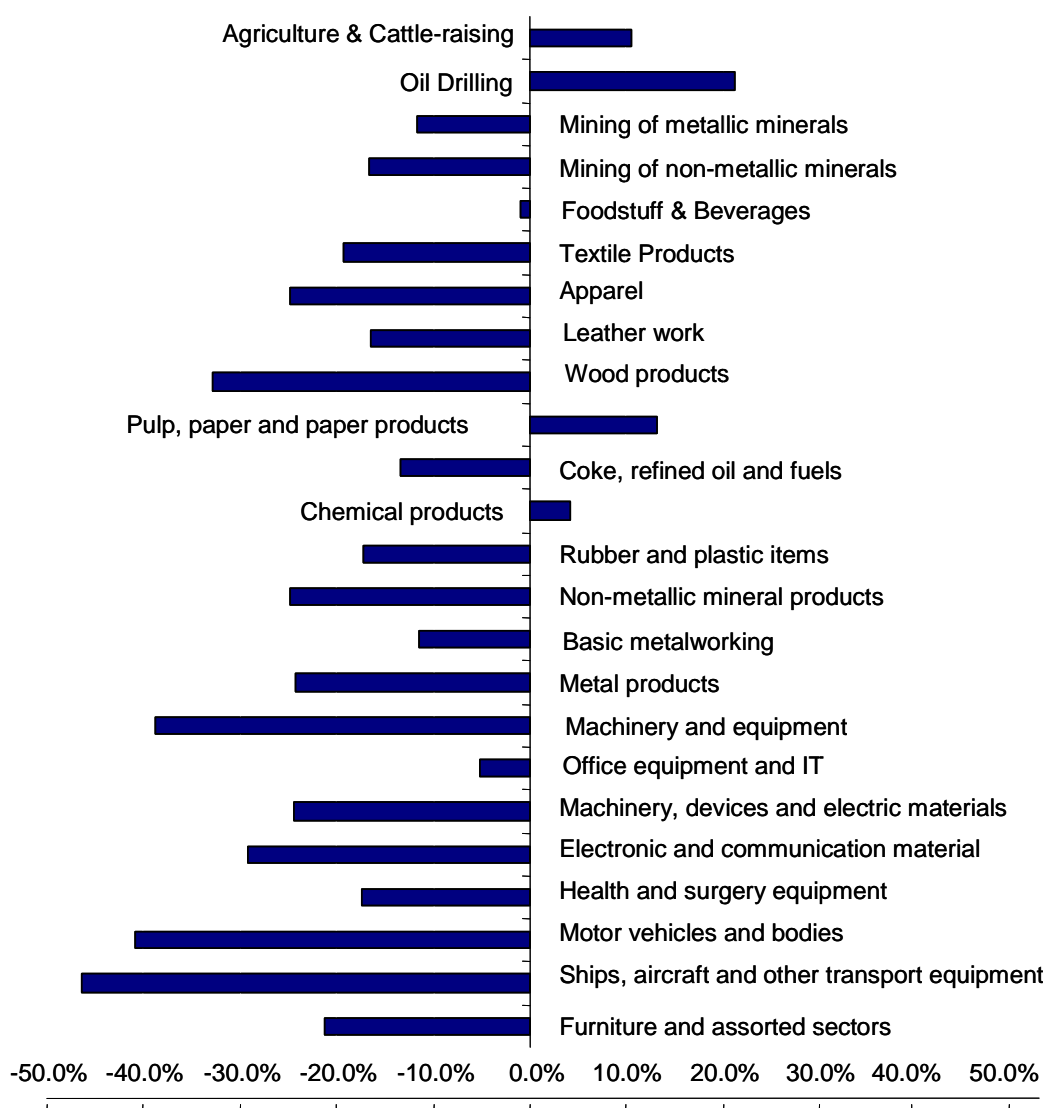
Growth in commodity exports is due both to price and volume. The *quantum* index calculated by Funcex shows that the increase in basic commodities in the period resulted from a 14.8% increase in the amount exported and 16.6% in prices. In semi-manufactured goods, prices rose more, boasting an increase of 23.4% versus 5.4% in volume.

Recovery was also apparent in some manufactured goods industries, especially the automotive sector, where car exports grew 65% in relation to the same period last year, while the auto parts sector jumped 41%. Despite the good performance of some manufactured goods sectors, this was the category that presented the lowest growth rate in the first quarter of 2010. While manufactured goods increased 17.9%, commodity exports rose 32.8%, and the exports of semi-manufactured rose 29.6%.

Throughout 2009, the main reduction in Brazil's exported volume occurred in industrial goods with increased industrial sophistication. According to the Funcex index, the most considerable decreases in the exported volume

were recorded in machinery, equipment and transport material (see Chart 3.2). The fall in world trade was more significant in industrial goods than in commodities, and the latter were somewhat supported by continuing demand in China. Significant growth occurred only in agriculture, cattle-raising and oil extraction sectors. Postponed investment decisions in the world, brought on by the crisis, particularly impaired foreign sales of capital goods, which largely comprise the exports that presented the most notable drop.

**Chart 3.2: Changes in volume of Brazilian exports per sectors of economic activity: 2009 / 2008 (in %)**



Source: Own development from Funcex data

The pattern in Brazilian foreign trade traditionally shows that the majority of manufactured goods exports go to the American continent, while commodities head to Asia and Europe. In the first quarter of 2010, the main destination of Brazilian exports was Latin America and the Caribbean, followed closely

by Asia (see Table 3.1). In the first case, the focus continued to be on Argentina and, among the Asian countries, on China, both of which presented growth in purchases of Brazilian products well above the average of their continents. For Argentina, the main products were passenger cars and auto parts (US\$ 1.0 billion); For China, iron ore (US\$ 1.6 billion) and oil (US\$ 1.0 billion).

In the world total, China (US\$ 4.6 billion) was the main destination of Brazilian exports within the period, followed by the United States (US\$ 4.3 billion), Argentina (US\$ 3.5 billion), the Netherlands (US\$ 2.2 billion) and Germany (US\$ 1.6 billion).

**Table 3.1: Brazilian exports per destination: January to March 2010**  
(In US\$ million)

	Exports		% Var. 2010/09	Imports		% Var. 2010/09	Balance	
	2010	2009		2010	2009		2010	2009
<b>Latin America and The C.</b>	<b>9,880</b>	<b>6,921</b>	<b>42.8</b>	<b>6,648</b>	<b>4,722</b>	<b>40.8</b>	<b>3,232</b>	<b>2,199</b>
. Argentina	3,549	2,236	58.7	3,107	2,189	41.9	442	47
. Santa Lucia	926	315	194.0	5	1	400.0	921	314
. Mexico	810	614	31.9	805	635	26.8	5	-21
<b>Asia</b>	<b>9,373</b>	<b>7,121</b>	<b>31.6</b>	<b>11,672</b>	<b>8,218</b>	<b>42.0</b>	<b>-2,299</b>	<b>-1,097</b>
. China	4,649	3,420	35.9	5,256	3,613	45.5	-607	-193
. Japan	1,259	986	27.7	1,562	1,482	5.4	-303	-496
. India	908	324	180.2	774	465	66.5	134	-141
<b>European Union</b>	<b>8,762</b>	<b>7,502</b>	<b>16.8</b>	<b>8,320</b>	<b>6,278</b>	<b>32.5</b>	<b>442</b>	<b>1,224</b>
. Holland	2,198	1,879	17.0	344	209	64.6	1,854	1,670
. Germany	1,622	1,232	31.7	2,666	1,979	34.7	-1,044	-747
. United Kingdom	934	827	12.9	656	473	38.7	278	354
<b>US <sup>(1)</sup></b>	<b>4,257</b>	<b>3,585</b>	<b>18.7</b>	<b>5,707</b>	<b>5,368</b>	<b>6.3</b>	<b>-1,450</b>	<b>-1,783</b>
<b>Middle East</b>	<b>1,896</b>	<b>1,357</b>	<b>39.7</b>	<b>920</b>	<b>540</b>	<b>70.4</b>	<b>976</b>	<b>817</b>
. Saudi Arabia	559	409	36.7	342	325	5.2	217	84
. Iran	347	196	77.0	34	15	126.7	313	181
. United Arab Emirates	304	240	26.7	64	26	146.2	240	214
<b>Africa</b>	<b>1,803</b>	<b>1,964</b>	<b>-8.2</b>	<b>2,644</b>	<b>1,375</b>	<b>92.3</b>	<b>-841</b>	<b>589</b>
. South Africa	302	314	-3.8	152	124	22.6	150	190
. Egypt	277	306	-9.5	10	10	0.0	267	296
. Nigeria	204	199	2.5	1,228	782	57.0	-1,024	-583
<b>East Europe</b>	<b>989</b>	<b>635</b>	<b>55.7</b>	<b>510</b>	<b>248</b>	<b>105.6</b>	<b>479</b>	<b>387</b>
. Russia	869	561	54.9	346	181	91.2	523	380
. Ukraine	62	25	148.0	60	40	50.0	2	-15
. Georgia	14	11	27.3	75	124	-39.5	-61	-113
Others	2,270	2,093	8.5	1,916	1,440	33.1	354	653
<b>TOTAL</b>	<b>39,230</b>	<b>31,178</b>	<b>25.8</b>	<b>38,337</b>	<b>28,189</b>	<b>36.0</b>	<b>893</b>	<b>2,989</b>

<sup>(1)</sup> Including Puerto Rico

Source: Own calculations using MDIC / Secex data

Brazilian exports to the United States have presented a course of growth that was lower than that for other destinations. In 2008, while total Brazilian exports grew 23% in relation to the previous year, exports to the United States increased only 9%. Last year, while Brazil's total exports fell by 23%, those for the United States decreased 43%. In that year, the United States lost its position as the main destination for China. However, during the last months in which imports to the United States have recovered, data shows that the growth rate of

Brazilian exports to that country is slightly higher than its total imports - see Box 3.1.

The only continent to show a decline in Brazilian exports in the first quarter was Africa, mainly due to the behavior of sales to Angola. In the first quarter of 2009, Brazilian exports to that country were at US\$ 422.8 million, and, in the same period last year, only US\$ 187.3 million. For many other countries, there was an increase in Brazilian exports, and, in addition to Nigeria, sales were higher to Morocco, Libya, Ghana, Senegal, among other countries with lower absolute value.

In the first quarter of 2010, Brazil achieved a significant trade balance with countries in Latin America and the Caribbean and, albeit at a lower magnitude, with the Middle East, Eastern Europe and the European Union.

Deficits to the United States and Asia, the latter being greatly motivated by China, mark different positions in Brazilian trade in relation to such countries. Since 2001, Brazil had a surplus with the United States, but, in 2009, this scenario reverted into a sizeable deficit (US\$ 4.4 billion) and the trend has remained in 2010. For China, there was a total surplus in 2009, different from the deficits recorded in 2007 and 2008. In 2010, behavior is back to what it was over the two previous years, but this does not necessarily indicate a definite trend for the rest of the year. The first months, even throughout the years with surplus, presented more modest balances than in other months.

The overall result of the Brazilian trade balance remained positive despite imports having grown at 10 percentage points higher if compared to exports in the quarter. The main items imported by the country were raw materials and intermediate products (48% of the total for the term). Also, consumer goods and fuels showed high growth rates, both above 40% in relation to the first quarter of last year. Particular emphasis is put on passenger vehicles, which grew 85%.

### **Box 3.1: The recovery of US imports**

The United States is the world's largest importer of goods and was one of the main focal points of the recent economic crisis. The reduction of income in the country due to the crisis proportioned the largest drop in terms of absolute imports in 2009. US foreign purchases decreased 26% in relation to the previous year, which meant the disappearance of over US\$ 500 billion in international trade demand if compared to 2008.

The following table shows the variation of imports from the United States at five different moments over the past 24 months, according to economic activity sectors. The first moment is the third quarter of 2008 which represents the last quarter with growth if compared to the same moment in prior years. Afterwards, there were successive falls in US purchases. The reduction had already become apparent in the last quarter of that year, but the worst phase of the crisis occurred in the second half of 2009. The beginning of a recovery arose in the last quarter of last year, evident in the slowdown of the fall. The last moment refers to the first two months of 2010: Brazil's imports showed significant growth, but they have not yet recovered the values posted over the two preceding years.

**Table 3.2: United States - Imports per industry, selected quarters of 2008-2009 and the first two months in 2010 (in %)**

Industry	2008		2009		Jan.-Feb. 2010/ Jan.-Feb. 2009	Jan.-Feb. 2010/ Jan.-Feb. 2008
	3Q	4Q	2Q	4Q		
Products animals	-0.4	-1.9	-7.5	-13.1	-4.6	-14.5
Products from plants	24.1	11.9	-13.2	-7.5	1.5	-3.1
Foodstuff	13.0	3.2	-8.6	-3.2	8.3	-0.1
Minerals	57.6	-13.4	-54.0	-14.2	49.2	-28.0
Chemicals	23.8	8.2	-17.8	-3.3	8.9	-7.7
Rubber and plastic	8.7	0.7	-27.0	-14.3	15.3	-11.2
Leather	1.3	-5.1	-22.9	-16.7	-1.8	-16.4
Wood Products	-8.9	-13.9	-30.1	-17.7	2.3	-25.1
Textile products	-2.5	-4.8	-16.4	-8.7	1.2	-13.2
Footwear	3.1	1.0	-14.0	-8.1	1.0	-6.6
Non-metallic mineral products	6.1	-19.6	-31.9	9.3	32.5	-18.0
Steel sector and metal products	16.3	4.4	-50.2	-36.3	-7.6	-29.0
Machinery, equip. & elect. material	4.3	-11.0	-24.2	0.2	12.5	-13.2
Transport material	-10.3	-23.2	-46.1	-0.6	36.5	-28.2
Other products	1.4	-6.1	-22.5	-9.2	8.2	-13.7
<b>Total</b>	<b>14.6</b>	<b>-9.0</b>	<b>-34.3</b>	<b>-7.9</b>	<b>17.6</b>	<b>-18.9</b>

Source: World Bank Trade Watch, April 2010

## SPECIAL REPORT

### The Argentine economy and the recent controversy on the use of international reserves

Alexandre Lautenschlager  
Fabrício Catermol<sup>1</sup>

#### Introduction

Early in 2010, Argentina became the focus of the international media owing to the dispute between the federal government and the central bank regarding the use of the country's international reserves. The controversy resulted in the issuance of a Decree of Necessity and Urgency (DNU) by President Cristina Kirchner in December 2009. The Decree ordered the transfer of US\$ 6.6 billion of the central bank's reserves in order to create the "Bicentenary Fund", which would be used to repayment public debts due this year. An institutional crisis arose from the refusal of the President of Argentina's Central Bank (BCRA), Martín Redrado, to perform the transaction, under the argument that it was necessary to assess the legal validity of the act and its tax consequences.

Faced with a stalemate, Cristina Kirchner dismissed the executive from his position, alleging he was not fulfilling his duties as a public official because he disobeyed a legal measure and tried to promote a political crisis. Redrado initially resisted dismissal, but less than a month later he admitted he was no longer responsible for BCRA's management. In his place, Mercedes Marcó del Pont, an economist with a graduate degree from Yale, and who, according to analysts is strongly aligned with official ideas, took on the job.

Meanwhile, the opposition, in possession of the newly acquired parliamentary majority, has set plans in motion to challenge the proposed measures in Congress and in court. However, the country's president, one step ahead of such a strategy, preventively cancelled the original DNU and issued it again in the form of two other decrees for the same purpose. The first one made US\$ 2.2 billion in reserves available to settle debts with multilateral creditors. The second transferred US\$ 4.2 billion in reserves to the Argentine Deleveraging Fund (*FDA - Fondo de Desendeudamiento Argentino*) to pay off debts to private creditors in 2010. Opponents undertook to present new challenges, but they are solely focused on the portion earmarked for the FDA, since the payment to multilateral institutions must comply with the current applicable law, the same that allowed the use of a similar mechanism in the dismissal of assets owed to the

<sup>1</sup> Respectively, economist and manager of the Foreign Trade Division of the BNDES.

IMF in 2006. The presidential measure was effectively rejected in Congress, but it is pending a decision in the Senate regarding its validity.

In view of the importance given to the matter over recent months, this paper aims at clarifying the situation of Argentine reserves and systematizing some of the arguments for and against its allocation for payment of public debt (such as those provided, for example, in Salvatore 2010a and b). One of the most important points is precisely whether the currently accumulated stock exceeds some "optimal" value, based on the Argentine economy's need to protect itself from external shocks. After this introduction, a summary of Argentina's performance in 2009 is presented, when the impacts of the international crisis were most strongly felt, based both on recent official documents from the country and analyses from the Institute of International Finance (IIF). The second section discusses more specifically the issue of the reserves, followed by a brief conclusion.

### **The Argentine economy in 2009**

Between 2003 and 2008, Argentina's economy had its largest growth cycle since the postwar period. The expansion was largely due to the recovery from the strong crisis that struck the country in the years immediately before and was owing to domestic demand, mainly investment, which increased its share in GDP from 11%, in 2002, to around 23%, in 2008, the highest value in the last 30 years. The country's economy has a traditionally strong agricultural export sector, besides well developed industry, in which the automotive sector stands apart. The *per capita* income (US\$ 14,000 according to the PPP concept) is high in Latin American standards, and the country has one of the highest literacy rates in the world.

However, after five years with average GDP growth of around 9% p.a., the Argentine economy began to feel the effects of the international crisis in mid 2008, which put an end to its expansion cycle. An important issue that came from the low confidence in official inflation statistics is the difficulty in assessing the actual path of the main Argentine economic variables. Thus, although it is clear that the crisis and a severe drought, both responsible for a 30% fall in grain production, significantly affected the country's growth, the government and private institutions differ considerably as to the result calculated in 2009.

According to data of the Ministry of Economy and Public Finance in Argentina (Meconi), GDP in the third quarter of last year would have presented a variation of -0.3% in relation to the same period in 2008. However, using calculations based on private estimates for inflation, the IIF's 2009 estimated drop in GDP in real terms would have been 2.6%, if compared with growth of 7.0% and



8.7% in the two previous years. According to the institution, in 2010, maintaining expansionary policies, better weather conditions and a record grain harvest will propel a recovery in GDP growth to 4.4% (Chart 1). In its most recent report, Argentina's Central Bank (BCRA) also reflected the expectation that the current year will continue along the path to recovering the economy. Besides the aforementioned factors, the monetary authority foresees a return of household consumption fostered by an increase in private credit and investments, which were quite low last year. Yet, the text of the document only refers to a "floor" for projected growth of 2.5%, pointing out that, among private consultancies that were consulted, the consensus is around 3.3%.

Chart 1: Effective GDP variation, 1 - 2007 (% pa)



Source: IIF, \* estimates and projections.

On the fiscal matter, the stimulus implemented by the Argentine government to fight the effects of the international crises accounted for approximately 1.3% of GDP. Such a push occurred both through increased expenditures and transfers by the public sector and through a slower pace of growth in tax collection, resulting from less intense economic activity. Since 2004, revenues and expenditures in the nonfinancial public industry have expanded their share in products almost continuously, but only in the third quarter of last year did the latter surpass the former (22.3% and 21.3%, respectively). The IIF estimates that in 2009 expenditures grew at a rate of 28%, while the variation of income was 10 percentage points lower.

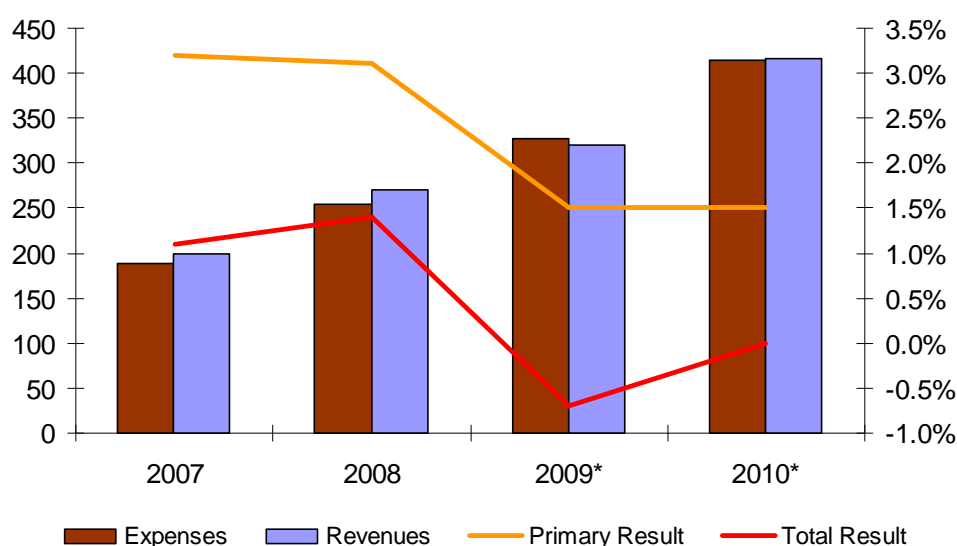
According to the most recent official documents, the expansion of expenditures was concentrated on capital expenditures (a 53% increase), distributed mostly between the capital transfers to sub national governments and direct real investment. The main components responsible for growth in tax collection were inflows from social security (69.2%) and value-added taxes (20.1%),



while duties on exports contributed negatively (-11.3%). As a result, the primary surplus disclosed showed a drop in keeping with what was foreseen in the budget to 1.36% of GDP. After deducting costs with interest, the nominal result is rated by the IIF as a deficit of 0.7% of the product, ending a 6-year cycle of surplus. Separately, the amount can be considered low if compared to those presented by other countries in the past year, but it must be remembered that a relevant portion of its funding came from extraordinary resources (allocation of the IMF's Special Drawing Rights and contributions from the Social Security Agency - ANSES).

For 2010, even upping some components in public expenditures, the BCRA works with a primary surplus in accordance with what was established in the yearly budget (PN-10), 2.3% of GDP. In contrast, the IIF, based on data from private institutions, admits that economic growth and increased agricultural exports should put the expansion of revenues once again above expenditures, but it foresees that the primary result will remain almost constant at 1.5% of GDP, while its nominal equivalent will be null (Chart 2). Out of total financing required for the year, which is estimated in US\$ 10.4 billion, it is expected that US\$ 6.4 billion will be covered by loans taken out with International Financial Institutions (IFIs), the Banco de la Nación and the BCRA. Another US\$ 1.8 billion is under government control, which poses no problem in its rollover, and the remaining US\$ 2.2 billion will come from international reserves.

Chart 2: Expenses, Revenues (AR\$ billion) and Fiscal Result (% GDP)  
2007 – 2010



Source: IIF, projections

Nevertheless, if the government maintains the same access conditions to resources, the budget deficit planned for 2011, of US\$ 2.5 billion, would have to be fully funded through the issuance of government bonds. In this context, the most recent document from the IIF does not rule out the possibility of the government attempting to amend BCRA's by-laws, changing the article that limits funding available to the federal government to 12% of the monetary base plus 10% of the tax collection from the previous year. At the same time, politicians could propose legislation requiring the private financial system to hold a larger portion of the public debt.

With regard to price indexes, in 2009 its upward trend was contained by a less intense scenario, but there still are strong differences between the figures released by the country's official statistics body (6.6%) and those estimated by private consultancies (between 16% and 18%). Mercedes del Pont replacing Martin Redrado in the administration of the Central Bank has analysts estimating that the new management will disseminate a view in which inflation must be characterized mainly as a problem of tight credit, thus restricting investment into an expansion in production. Criticism of this argument is based on the fact that it is not possible for growth rates in investment to cope with the expected 25% increase in demand in 2010. Consequently, the survey on inflation expectations conducted by the Universidad Torcuato Di Tella shows a variation of 31.1% in the aggregate result for the next 12 months. This figure reflects the concern with which the government must ensure significant increases for its employees, so the increase of prices does not corrode its popularity even more so, while simultaneously encouraging the private sector to do so.

In the foreign sector, usually the result of the Argentine current accounts closely accompanies the trends of the trade balance. Over the past year, both remained positive, given the most pronounced fall in imports if compared to exports. According to the BRCA's estimates, foreign sales of goods dropped 21% in 2009, amounting to US\$ 55.5 billion. Purchases, down due to the lower level of activity, would have fallen even more strongly, by 32%, amounting to US\$ 39.0 billion. This dynamic enabled the country to obtain a trade balance of 3% of GDP, which is 34.9% higher than in 2008.

In the 2009 accounts, the IMF's Special Drawing Rights (SDRs) were recorded in the current transfers account, increasing an already substantial surplus in such account (the eighth consecutive year, in the longest sequence in Argentine history). In 2010, the consultancy company Econviews foresees a current surplus of US\$ 9.5 billion, a deficit in capital of US\$ 4.5 billion and an increase of approximately US\$ 5 billion in international reserves. According to BCRA's analysis, the return of Argentina's economic growth will result in an in-

crease in imports, mainly of intermediate inputs (energy and industry) and consumer goods. On the other hand, the agricultural and cattle-raising sector is expected to benefit from better weather and a recovery in international prices of its products. Exports of manufactured goods, especially in the automotive sector, will also grow, following a recovery in the Brazilian market. Adding these factors together, the contribution of the trade balance, despite the perspective of continued accumulation of reserves, will be relatively lower than in 2009.

### Argentine reserves

At the time the President issued the order, stating that US\$ 6.6 billion of Argentine reserves would be used for payment of debts maturing in 2010, one of the arguments that opponents to the measure used was that it represented the federal government's appropriation of funds owned by the Argentine people, and which were accumulated through the efforts of private sector exporters.

However, a more detailed analysis draws attention to the fact that treating international reserves as "wealth" ignores the fact that, in effect, such funds are a variable within the broader macroeconomic model. For a given flow of currency via current transactions or financial account, its level is ultimately determined by the economic decision on how to meet two kinds of purposes: protection against external shocks and fostering the country's international competitiveness through a depreciated exchange rate (Salvatore, 2010b).

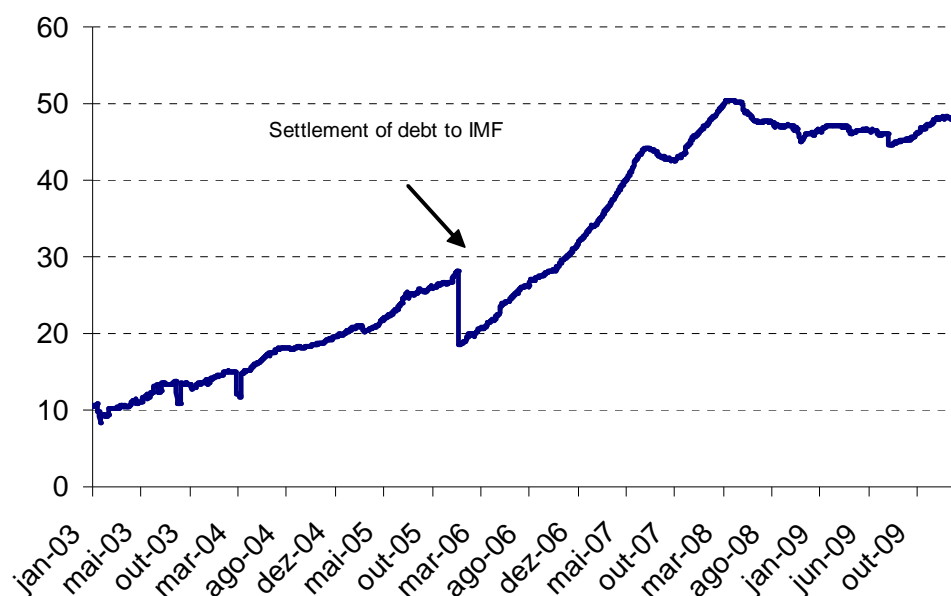
Thus, Aizenman and Lee (2005) provide empirical evidence that the "precautionary" reason prevails over the "mercantilist" reason in the explanation of the accumulated amount of international reserves in most countries. In such cases, the role assigned to international reserves is to ensure that "sudden stops" in external capital flows, coupled with financial or exchange crises, are not fully reflected in a reduction in domestic absorption. Furthermore, as the incidence of such events itself depends on the perception of agents with respect to the authorities' ability to respond to unforeseen events, the accumulation of reserves also helps prevent adverse events in the balance of payments. In fact, Garcia and Soto (2004) consider that, statistically, the level of reserves is highly relevant to prevent crises, even when the outcome is controlled for the level of development of the usual institutional variables.

In the specific case of Argentina, there has been an option for managing the exchange rate according to a semi-fixed regime since 2002. In such circumstances, the accumulation of reserves becomes an endogenous variable, as the net inflows of currency demand the expansion of the monetary base and the subsequent issuance of government bonds for their "sterilization". In the words

of the president of the central bank, Marcó del Pont: "[the accumulation of reserves] was not a goal in itself, but rather the counterpart of a strategic decision to maintain a competitive exchange rate." As there is no ceiling, it is possible that the value of international reserves exceeds what is strictly required to provide external protection. As noted by Rodrik (2006), reserves imply a given "social cost", which is defined as the difference between its spread and the cost of external indebtedness. Therefore, it is economically and socially justifiable to question the alternative use of a portion of the reserves that is shown to be a surplus.

In 2005, the positive scenario allowed Argentina to accumulate reserves above the level that the authorities consider desirable, allowing payment of the outstanding debt to the IMF in the amount of US\$ 9.5 billion. With the continuity of the trade balances in the following years, in 2009, the accumulated value of US\$ 48 billion once again represented a high point in its history, allowing a new discussion on its appropriateness (Chart 3). Using the official estimate of the balance of payments in 2009 as a reference, such assets provide a coverage equivalent to 9.4 months in expenditures on importing goods and services and payment of income. Likewise, they are equivalent to 40.7% of the total foreign debt.

Chart 3: International Reserves, 3 - 2003 (US\$ billion)



Source: BCRA

Still, in Salvatore's opinion (2010a), the official value is partially overestimated by what the author calls "creative accounting". Through this, included in the assets is about US\$ 15 billion in deposits in US dollars from private banks with the central bank and loans borrowed from BIS, which are actually BCRA's liabilities. Even then, if accounted in the traditional way, the US\$ 32 billion in reserves would be higher than the target usually pursued by the monetary authorities in most countries.

In some developed countries, historically, the rule of thumb for determining the necessary level of international reserves for "transactional" purposes is the coverage of three months in imports. Another known manner to assess its suitability is the so-called "Greenspan-Guidotti" rule of equivalence with the total short-term external debt. Theoretically, the relationship is justified by the fact that the accumulation of reserves is equivalent to the payment of short-term debts through the issuance of longer-term commitments. The latter have a lower risk of rollover, but are also subject to higher interest rates. One explanation for the reason why the private sector can not perform its own accumulation of reserves, independently from the government, is exactly the advantage that the latter can have in issuing a longer maturity bond (Jeanne and Rancière, 2006).

For Argentina, it is argued that its lack of access to the international credit market, coupled with the possibility, which is traditionally present in the country, of domestic resources fleeing to other currencies, requires a higher level of international reserves than usual. This perspective implies conditioning the variable to the evaluation of private agents of the macroeconomic policy implemented by the government, but it is necessary to emphasize that even in one of the worst scenarios conceived in relation to a lack of trust in the Argentine peso, the reserves held by the BCRA are still sufficient to convert approximately the entire monetary base. In more realistic projections, it is expected that, along 2010, there will be negative net demand for foreign currency and that the government will easily implement the rollover of its bonds with a domestic financial system that is quite liquid, approving the assessment of a relative surplus of reserves.

There is not a well-established response in the literature on how to invest reserves that exceed the "optimal" level, but it seems reasonable that there are exceeding net assets available with low return to cope with the most urgent needs for cash, which would otherwise depend on costly funding. Among others, the following includes some issues according to which the use of reserves could be positive: 1) to positively indicate Argentina's ability to pay, lowering interest rates, increasing credit in the public and private industries and investment, and, consequently, alleviating the medium term inflationary pressures;

and 2) to be allowed, together with the rescheduling of an outstanding debt, to attain sufficiently favorable financing conditions to implement a "virtuous circle" of public debt management (Salvatore, 2010a p.3-4)

This evaluation is reflected, for example, in the favorable manner in which the financial markets reacted to the reiteration of the commitment to paying the debt, even using the reserves. Several peak values in the country's risk were more directly associated to the intense political confrontation between the government and the opposition, returning to pre-crisis levels as the discussion went into a tailspin. In fact, more attention has been paid to the ongoing process to renegotiate the outstanding debt of the 2001 default, which, if successful, would return Argentina to the international market of volunteer credit.

A qualitatively different issue refers to whether the continuous use of reserves is sustainable. In this case, insisting on increasing current expenses contributes very little to the increase of Argentina's production capacity and adds demand pressures to an economy with inflation that is already higher than it is in its neighboring countries, besides signaling that it has already incorporated a significant inactive component. In particular, the fact that the official statistics cannot gain the trust of private players is especially damaging to the coordination of price adjustments, since it allows idiosyncratic errors in forecasts to be directly reflected in the aggregate rate. In a sense, it is likely that the reversal of such a scenario could be more than sufficient to disregard extraordinary measures (ibid. p. 8).

## Conclusion

The international crisis, the effects of which were more clearly felt in 2009, in spite of causing a temporary reversal in the growth rate of the Argentine economy, did not have more severe immediate consequences on the country considering its external balance. On the contrary, the continued accumulation of international reserves in the central bank once again raised the debate on the use of the portions that are in excess of what was necessary to protect the economy against shocks from different sources. Private projections for the main macroeconomic variables in 2010 do not indicate a real risk that would justify much higher values for reserves, and even in the case of a severe crisis of trust in the peso, the current accumulated value is sufficient to guarantee the convertibility of almost all the monetary base. So, there are arguments in favor of using a portion of these resources to pay off public debts, but the result of the increases in current expenditures with low trust in the private sector concerning price indexes is an important uncertain factor with regard to short-term stability. A more consensus-based assessment among analysts is that improving

the foreseeability and reducing inflation would bring substantial gains to the country's capacity to borrow externally at a lower cost.

### References:

AIZENMAN, Joshua e LEE, Jaewoo. International Reserves: Precautionary vs. Mercantilist Views, Theory and Evidence. IMF Working Paper 05/198, 2005.

GARCÍA, Pablo e SOTO, Claudio. Large Hoarding of International Reserves: Are They Worth It? Central Bank of Chile Working Papers Nº299, 2004.

JEANNE, Olivier e RANCIÈRE, Romain. The Optimal Level of International Reserves for Emerging Market Countries: Formulas and Applications. IMF Working Paper 06/229, 2006.

RODRIK, Dani. The Social Cost of Foreign Exchange Reserves. NBER Working Paper 11952, 2006.

SALVATORE, Nicolás. Acerca del Fondo del Bicentenario. Buenos Aires City (UBA) Nota Nº2, 2010a.

SALVATORE, Nicolás. Fondo del Bicentenario Reloaded: Por Qué Si y Por Qué No. Buenos Aires City (UBA) Nota Nº3, 2010b.

LA NACION. “Dicen que es “acotada” la visión de la inflación”. ([http://www.lanacion.com.ar/nota.asp?nota\\_id=1251049](http://www.lanacion.com.ar/nota.asp?nota_id=1251049)), 06.04.2010.