8. Capital inflows will drive the FX rate towards real appreciation

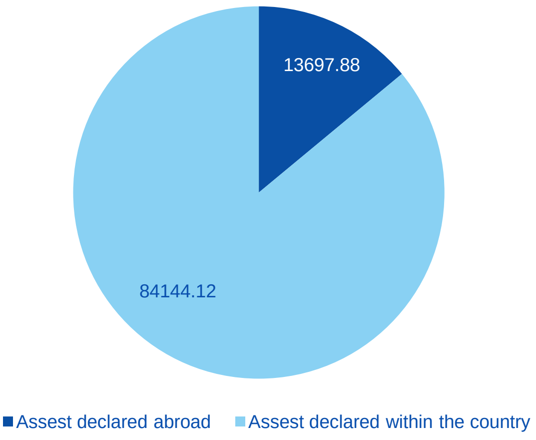
Following the elimination of exchange rate restrictions at the end of 2015, FX rose and 2016 ended with a nominal exchange rate depreciation of close to 40%, concentrated almost exclusively in the first half of the year. In the second half of the year, a monetary policy and external financing scenario began to materialise, which we believe will prevail in 2017, so we do not expect large changes in the exchange rate in the medium term. The exchange rate will increase by 13.2% in 2017 to average ARS 17.8/USD in December 2017 and ARS 18.4/USD (+3.4%) in 2018, in both cases a devaluation lower than inflation.

This forecast is supported by a number of factors, such as the Central Bank's free floating exchange rate policy, the maintenance of positive interest rates in real terms that discourage domestic savings in foreign currency, capital inflows to finance private investment partly due to the success of tax amnesty (Figure 8.1), and finally, debt placements to finance the public sector deficit. Recently, the BCRA has lifted some of the latest restrictions still affecting the foreign exchange market, extending the 10-year export settlement period and eliminating the 120-day rule for financial investments. It is expected that in 2017 capital inflows will also outstrip the current account deficit and accumulate reserves and downward pressures on the exchange rate. Within the framework of this medium-term trend, we cannot completely rule out short-term episodes of volatility, taking into account the local electoral cycle or episodes of risk aversion triggered by the international scenario.

In this context, we expect to consolidate a period of real appreciation of the exchange rate over the next few years. Although in the absence of exchange controls and taking into account that the BCRA practically does not intervene in the exchange market, it can be said that the spot exchange rate does faithfully reflect the supply and demand trends of the economy, there are concerns about the excessive strength of the Peso and the sustainability of the scheme. In this sense, it is possible that the economy can currently sustain a real equilibrium exchange rate that is more appreciated (Graph 8.2), considering that there has been a considerable reduction of export taxes and a substantial reduction in the cost of capital for Argentina after the arrangement with the hold-outs, but much will depend on what happens in the main trading partners.

Figure 8.1

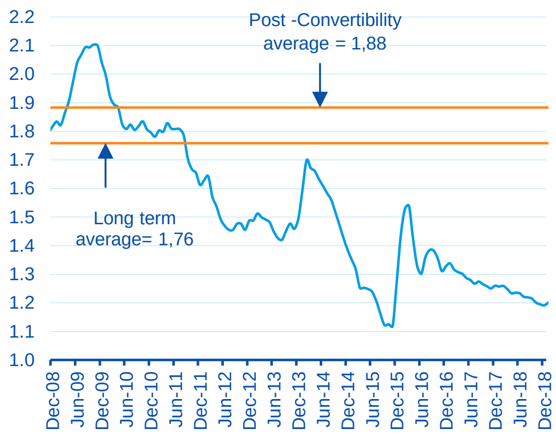
The results of Tax Amnesty



Source: BBVA Research

Figure 8.2

Multilateral real exchange rate (Index base 2001=1)



Source: BBVA Research

DISCLAIMER

This report has been produced by the Argentina Unit

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