8. “Verbal” intervention by the Central Bank to put a cap on the peso’s appreciation

New target for accumulation of reserves

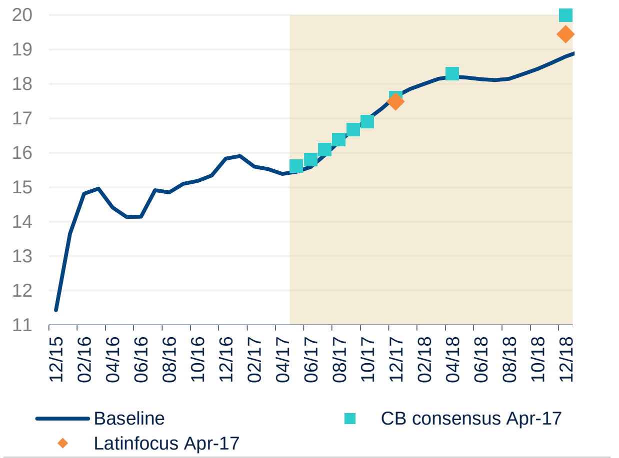
In the base scenario we are not expecting significant depreciation in the exchange rate in the medium term. On the contrary, we are expecting a period of real appreciation of the exchange rate although volatility in the short term prior to the midterm cannot be discarded. The exchange rate will increase 11.4 % in 2017 (ARS/USD 17.6) and 6.6% in 2018 (ARS/USD 18.8) at a slower pace than inflation (see figure 8.1).

This forecast, which is shared by most analysts, is supported by a number of factors, such as the Central Bank’s monetary and exchange rate policy, the maintenance of mildly positive interest rates in real terms that encourage domestic savings in local currency, capital inflows to finance private investment (partly due to the success of the fiscal amnesty) and, finally, debt placements to finance the public sector deficit as well as private debt issues.

The President of the Central Bank recently stated, for the first time, that Argentina’s stock of international reserves was still low in international terms and that the intention was to raise the international reserves to GDP ratio to 15%, which involves an increase in reserves of at least 50% compared to the current level of around USD 48 billion. Although the current level of reserves is adequate in terms of months of imports and short term dollar denominated debt maturities (see Figure 8.2), it still fall below what might be considered an optimal ratio of reserves of around 14% of GDP. The 2017 Monetary Targets succinctly mention that the Central Bank may carry out transactions in the exchange market to strengthen its external assets, but the accumulation of international reserves does not appear as a specific target. The argument the governor of the CB is now putting forward is that this is required by the risk rating agencies to raise the country’s rating and as a strategy for protection against external shocks, as other emerging economies have done. Although the Central Bank did not define a time frames for reaching the reserve ratio, the initiative puts a cap on the peso’s upward trend which is also probably one of the desired effects. Although it is no longer mandatory to settle exports immediately, it is likely that the Central Bank will continue to purchase reserves arising from National and Provincial debt issues.

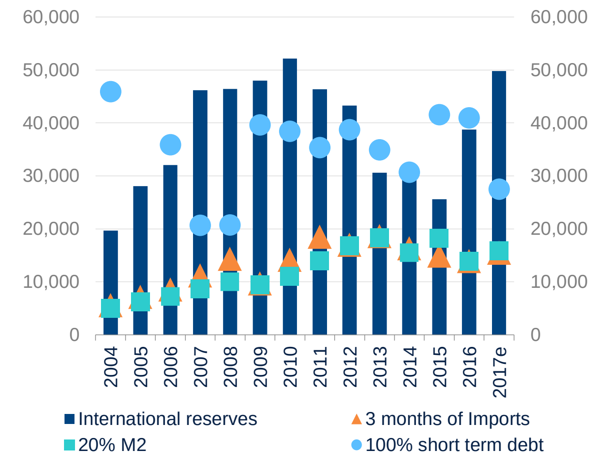
We believe that a stronger real exchange rate is sustainable in the medium term because the cost of capital for Argentina has fallen substantially, the majority of export taxes have been eliminated and there is abundant global liquidity to finance the domestic deficit. Nevertheless, the strong peso is causing problems due to a lack of competitiveness in some industrial sectors which will require the government to put policies in place to improve these sectors’ productivity in the medium term.

Figure 8.1 Forecast and expected exchange rate (ARS/USD)



Source: BBVA Research, Central Bank and Latinfocus.

Figure 8.2 International reserves ratios (USD millions)



Source: BBVA Research, Central Bank and Indec.

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