

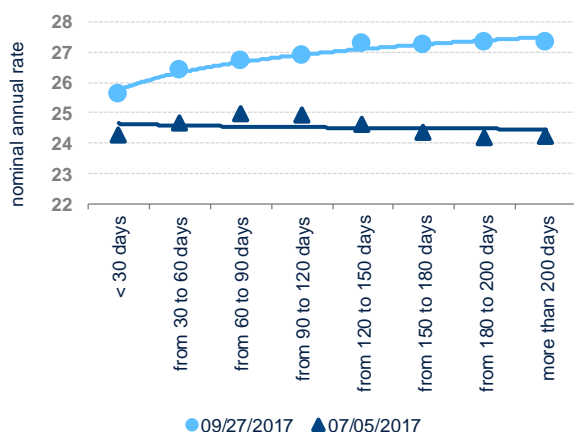
## 5. Still far from target, the Central Bank of Argentina will maintain its contractionary bias

### Inflation and expectations have not been reduced to levels consistent with the Central Bank's target range

Monetary policy deepened its contractionary bias in the third quarter, as not only did the Central Bank of Argentina keep its monetary policy rate (TPM) unchanged since April (see Figure 5.2), but it also intervened in the LEBAC secondary markets and increased the longer-term rates (see Figure 5.1). In principle, this does not appear to be consistent with the target of anchoring inflationary expectations downward, but the Central Bank's strategy is aimed at making the longer-term Lebac's more attractive and bringing down the high volume of short-term maturities. Indeed, the monetary policy rate decision and the primary Lebac auctions were eclipsed in terms of importance by the daily Lebac buy and sell transactions in the secondary market. Because of the absorption in the secondary market, the Monetary Base has only grown 5% over the year so far, neutralising the issue of pesos originated in treasury funding and acquisition of FX from bond placements abroad.

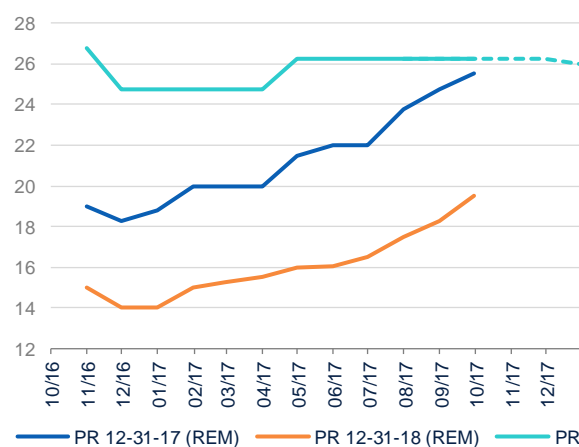
Although the policy rates in real terms are at their highest levels since the government took office, the Central Bank is not expected to make changes to the monetary policy rate until the end of this year when there should be the first actual evidence that inflation is moving towards the expected values. Thus, we expect the monetary policy rate to reach 26% at the end of 2017, and to fall by only 600 bp in 2018. The Central Bank will maintain its focus on strengthening its reputation, and will insist that it will use all the instruments at its disposal to bring inflation to converge at the target range. In turn, the obvious recovery in activity is helping to temper criticisms about the negative impact of high interest rates on the economy and electoral preferences, giving the monetary authority more leeway to maintain its tight bias.

**Figure 5.1** Lebac yield curves (%)



Source: BBVA Research based on BCRA data

**Figure 5.2** Monetary Policy Rate vs. REM estimates (%)



Source: BBVA Research based on BCRA data

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