

## Argentina: Robust policy shifts suggest steadier FX trends

With the announcement of decisive fiscal and monetary measures today, we expect the ARS to find stronger footing, and even appreciate slightly in the coming weeks



Source: [www.buenosairesfotogenica.com](http://www.buenosairesfotogenica.com)

The Argentinean peso, which had been suffering from the government's decision to weaken the central bank's inflation mandate, is likely to stabilise, following the very hawkish course-correction announced in the past few days.

On the monetary policy front, BCRA raised the reference rate by 6ppt today, to 40%, accumulating a 12.75ppt increase over the past week. The bank's repo corridor was also widened materially, with the 7-day active (lending) rate set at 47% and the passive (borrowing) rate set at a much lower 33%. The one-day repo rate was set at 57%.

Today's announcement also indicated that appetite for FX intervention remains intact, but concerns regarding the rapid depletion of FX reserves that took place over the past weeks pushed the bank to broaden its approach. Following the experience of Brazil's BACEN and Mexico's Banxico, the BCRA will also intervene through FX derivatives, providing FX hedge that settles in ARS and does not affect the level FX reserves. Also, BCRA is also demanding that local banks sell, as of 7 May, all

of their FX holdings that exceed 10% of their total liquid assets.

Room for direct spot FX intervention is relatively limited now. Gross FX reserves have now dropped to US\$56bn, down from a US\$64bn peak in January. Assuming that private sector FX deposits and an FX swap with China account for about US\$23bn of that, net FX reserves are approaching the US\$30bn threshold, beyond which market concerns could rise.

BCRA's decision was complemented with the announcement, also this morning, of a much-needed fiscal policy tightening, with the Finance Ministry announcing a 0.5ppt-of-GDP reduction in the 2018 primary fiscal deficit target, from 3.2% of GDP to 2.7%, which aims to cap the overall fiscal deficit at 5% of GDP.

The Argentinean peso's medium-term outlook remains weighed down by the worrying rise in its current account deficit, which appears to be rising towards an unsustainably high 6% of GDP, and the country's strong reliance on external debt issuance to finance that deficit. Today's fiscal tightening aims, in part, to address this rise in the twin-deficits, which should top 10%-of-GDP this year, and has made Argentina especially vulnerable at a time that FX financing costs and risk aversion are rising.

But, having depreciated by more than accumulated inflation over the past two years, since after the Macri administration allowed the currency to float in December 2015, we suspect the ARS entered overshooting territory yesterday, and consider a level closer to 21.5 to be more aligned with the "fair-value" for the peso right now. Given the strong resolve suggested by today's action, we would be surprised if the ARS doesn't stabilise and even appreciates over the next few weeks.