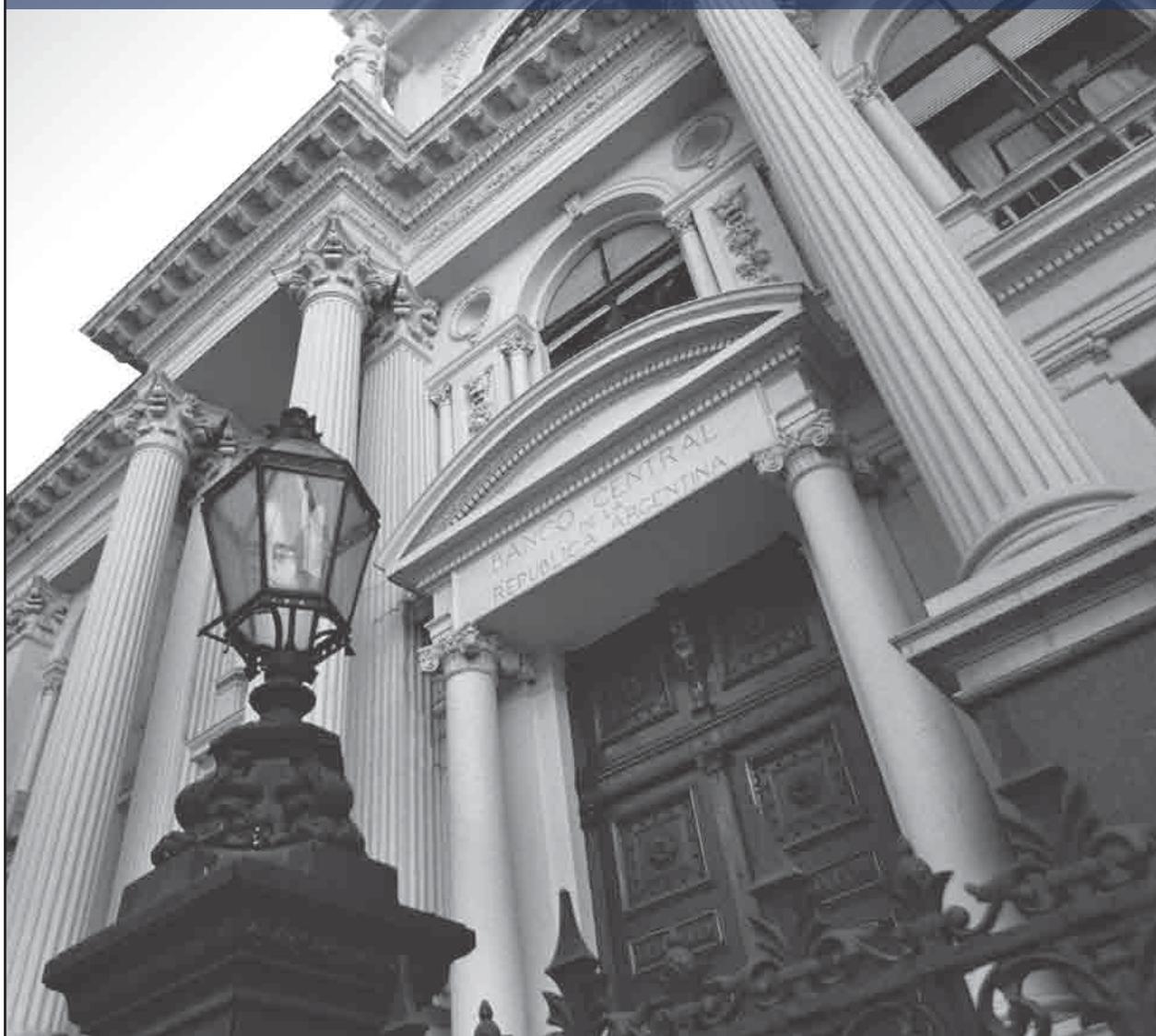


Targets and programs for the development  
of monetary, exchange rate, financial  
and credit policies for 2016



December 2015



BANCO CENTRAL  
DE LA REPÚBLICA ARGENTINA

# Targets and programs for the development of monetary, exchange rate, financial and credit policies for 2016

*“The purpose of the Bank is to promote –to the extent of its powers and within the framework of the policies set by the National Government– monetary stability, financial stability, employment, and economic development with social equity.”*

Section 3 – **Charter of the Central Bank of Argentina**



**BANCO CENTRAL  
DE LA REPÚBLICA ARGENTINA**

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# 1 | Guiding Principles

In line with the provisions of Section 3 of its Charter, the first target of the Central Bank will be to ensure the monetary stability of the Argentine economy. In the current context, this objective means prioritizing a decrease in the rate of change of domestic prices, to levels similar to those of emerging economies that manage their monetary policy under inflation targeting regimes (see Annex I: “Inaugural Address and Management Guidelines by the Governor of the BCRA”).

The priority seeking to obtain, within a reasonable term, a domestic currency with a stable purchasing power entails leaving aside objectives inherent in the country’s monetary management, traditionally focused on the currency external value, i.e. on the exchange rate. Instead, the Central Bank considers that a floating exchange rate is essential to attain a gradual decrease in the inflation rate, and it also allows for starting to decouple the dynamics of domestic prices from the evolution of the exchange rate. In the past, rigid exchange rate regimes were a previous but inexorable step towards monetary devaluation, and have therefore contributed to inflation expectations that eventually held true. A floating regime means that the Argentine peso may appreciate or depreciate against other currencies according to the circumstances, within a path consistent with a declining inflation.

Secondly, and also in line with the provisions of Section 3 of the Charter, ensuring the financial sector’s stability and growth will be another priority of this Bank, with the conviction that this is the optimum path to contribute to the last target of its task: economic development with social equity. The Central Bank will focus its main actions on the development of a domestic financial system and, in this same line, on the promotion of savings instruments in domestic currency, encouraging the Argentines to save in pesos. These measures will strengthen the credit system, which will serve as a channel to promote productive development and to enlarge the supply of mortgages at more affordable rates and terms for the population at large.

The third fundamental pillar of the Central Bank’s targets will be a decisive promotion of bankarization in order to facilitate the role of money as a payment system. In this sense, the Bank will adopt, as priority agenda, the world trend towards electronic means of payment. Encouraging a massive use of IT-based means of payment and facilitating access to them by the entire population is tantamount to hindering organized crime, drug-trafficking and money laundering. At the same time, bankarization contributes to reducing the shadow economy, allowing for a much more even and moderate tax burden.

Within the framework of these guiding principles, the Central Bank establishes the following targets and programs for next year.

## 2 | Monetary and Exchange Rate Policy

The BCRA's gradual loss of focus on the functions stated in its Charter was a key aspect of the Argentine macroeconomic deterioration of the years prior to 2015. The Argentine macroeconomic situation needs to regularize, and the Central Bank plays a significant role in this objective; a considerable part of its agenda for 2016 will continue with the regularization started in December 2015.

### ARGENTINA'S MONETARY AND MACROECONOMIC SITUATION UNTIL DECEMBER 2015

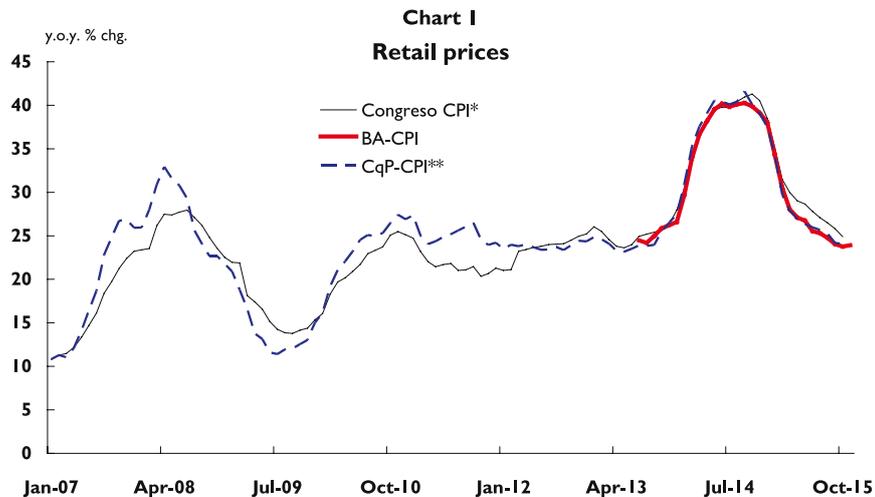
The Argentine macroeconomic indicators suffered a serious deterioration during the first half of the 2010s, posing an important challenge for the management of the economic policy in general, and the monetary policy in particular. Up to December 2015, the country had already gone through several years of low or no economic growth; a persistent inflation over 25% since 2007; a record-high fiscal imbalance, financed in part by the Central Bank; a system of multiple exchange rates that punished the generation of foreign currency from exports (already punished by high taxes on foreign sales of the farming sector) and of investments, which in turn encouraged the use of foreign currencies for imports and external tourist activities; and a judicial situation of its public debt that contributed to a higher country risk premium than that of other countries of the region.

The aggregate production of goods and services remained virtually stagnant during the last four years, under a dynamic that showed an increase in the share of public and private consumption in GDP in detriment of the economy's investment rate.

In this context of scarce economic growth, inflation<sup>1</sup> stood at around 25% per year since 2007, regardless of the cyclical fluctuations associated with the unfavorable external context (2009) or of movements in the value of the currency (2014) (Chart 1). Argentina has shown two-digit inflation figures for one decade, i.e. values that are significantly higher than the international average inflation level for that period (4.1%). This dynamic of domestic prices weakened the value of our currency and led to partially-offsetting devaluations.

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<sup>1</sup> According to several indicators, such as the Consumer Price Index released by the National Congress or indexes based on calculations of sub national statistical data institutes.



\*Congreso CPI started being published on Apr-11. For previous data, it was considered the average of calculated CPI by private consultants.

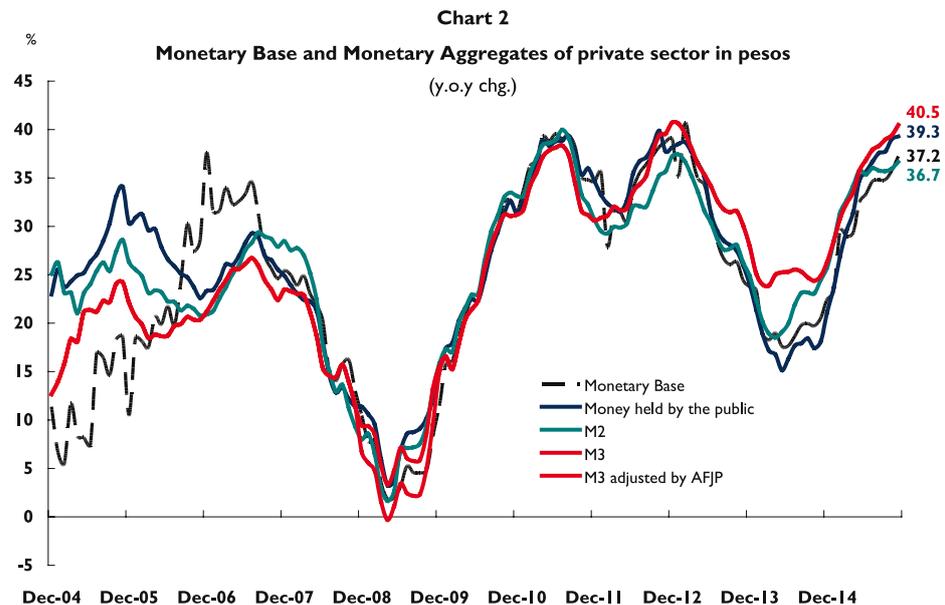
\*\* "Cosas que Pasan" website CPI. It is calculated as the geometric weighted average of a selected number of provincial CPI. Weights are proportional to the correlation that CPI used to have with IPC-GBA.

Source: CABA Statistical Office, Private consultants, "Unión por Todos" party and CqP index

Public finance exhibited a systematic deterioration in the last five years, going from a balanced financial result of the National Non-Financial Public Sector (SPNF) –on a cash basis– to deficit levels showing an increasingly negative dynamics. Even though income expanded at high rates, primary expenses went up at a faster pace. Several expense components encompass adjustment mechanisms outlining a path of an inertial increase of public expenditures. These expenses are related to social security payments, promotion and social aid plans, and remunerations. All together, these items account for more than 60% of the SPNF’s primary expenses.

The deterioration of public finance was accompanied by the Treasury’s increasing dependence on the different aid tools provided by the Central Bank (temporary advances, transfer of profits and issue of Non-Transferable Bills as compensation for the use of international reserves). This fiscal dominance, entailing an increasing monetary expansion and/or reduction of international reserves through these channels, limited the capacity of the Central Bank to meet the targets stated in its Charter.

The expansionary policy adopted by the Central Bank is clearly seen in the growth of the monetary aggregates, since they expanded sharply from a level around 20% before the subprime crisis to a 30%-40% year-on-year range as from 2010, with a temporary interruption between 2013 and 2014 (Chart 2).



Note: The change in the Monetary Base is influenced by modifications in minimum reserve requirements. Source: BCRA.

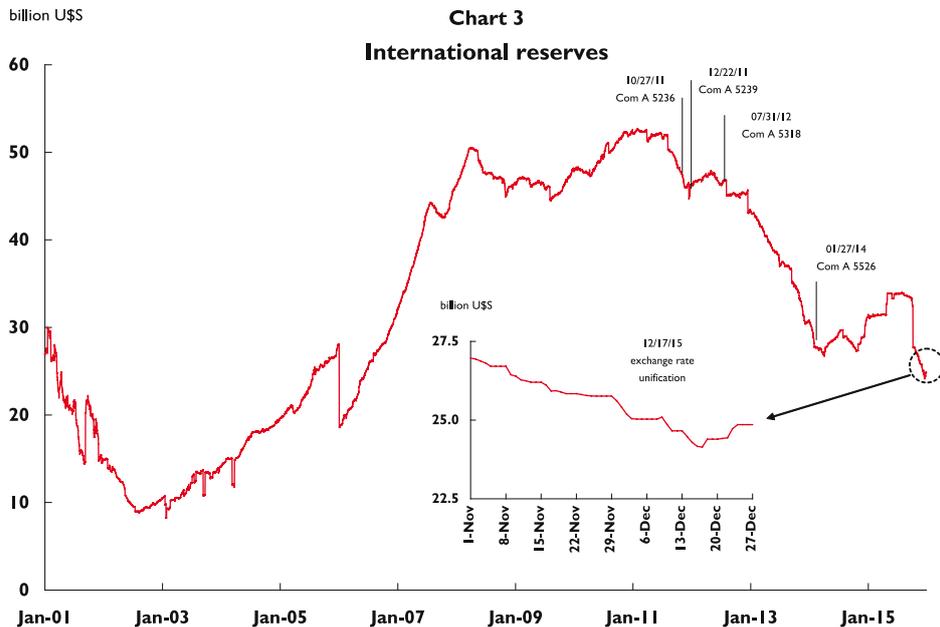
While the financing demands to the Treasury increased the Central Bank's liabilities, the use of reserves for debt payment and the overall deterioration of the external accounts weakened its assets. The foreign trade balance has gone down from a surplus of US\$ 12.2 billion to a deficit of around US\$ 2.2 billion.<sup>2</sup> The imbalance of external accounts was worsened by the multiple exchange rates system, which subsidized external tourism and the purchase of Central Bank's reserves by the public, and punished exports and the inflow of external investments.

As from 2011, limitations were established to the purchase of dollars for savings, the distribution of dividends of foreign companies to their head offices abroad and the payment of imports. Thus, as from October 2011, new requirements were established for accessing the foreign exchange market for transactions related to foreign assets formation of residents without the obligation of a specific further application<sup>3</sup> and, as from July 2012, it was ordered that such transactions could only be made with the previous authorization by the BCRA.<sup>4</sup> Despite the fact that, at the beginning, these measures turned out to be partially effective to contain the sale of foreign currency in the foreign exchange market, it soon became evident that they acted more as a curb to supply, rather than demand, of foreign currencies, which translated into a severe cost in terms of economic activity. As a result, international reserves continued to exhibit a sharp declining trend (Chart 3).

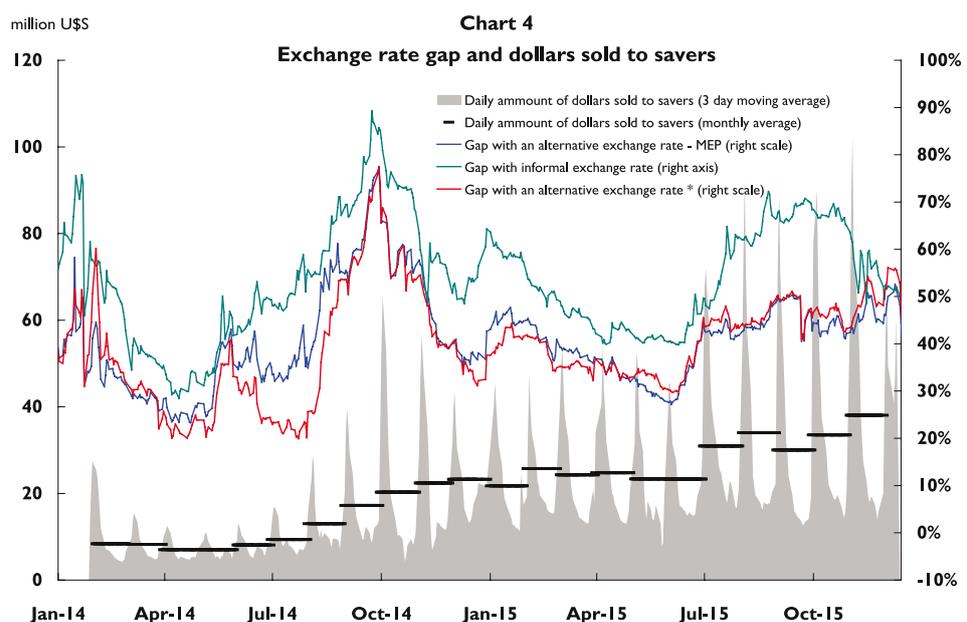
<sup>2</sup> Based on information corresponding to the last twelve months up to November 2015, according to Trade Database – INDEC.

<sup>3</sup> See the summary of the exchange rate regulations in force at year-end 2011 in <http://www.bcra.gob.ar/pdfs/comytexord/P49991.pdf>.

<sup>4</sup> See the summary of the exchange rate regulations as of September 2012 in <http://www.bcra.gob.ar/pdfs/comytexord/P50122.pdf>.

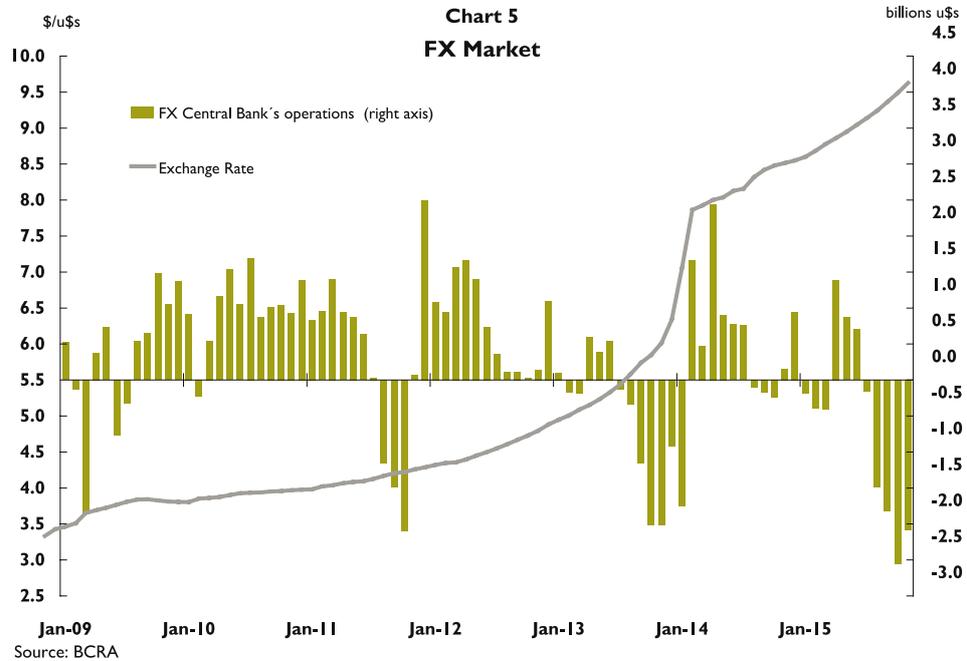


The combination of an expansionary monetary policy and a controlled exchange rate scheme for commercial, savings and external tourist transactions worsened the tensions in place in the foreign exchange market. This was evident, for example, in the widening of the gap between the official exchange rate and the informal exchange rate and/or the exchange rates implied in the trading of securities in the market and in the amounts of dollars sold to savers who obtained the authorization by AFIP (Argentine Tax Authority) to purchase them at the official exchange rate (Chart 4).

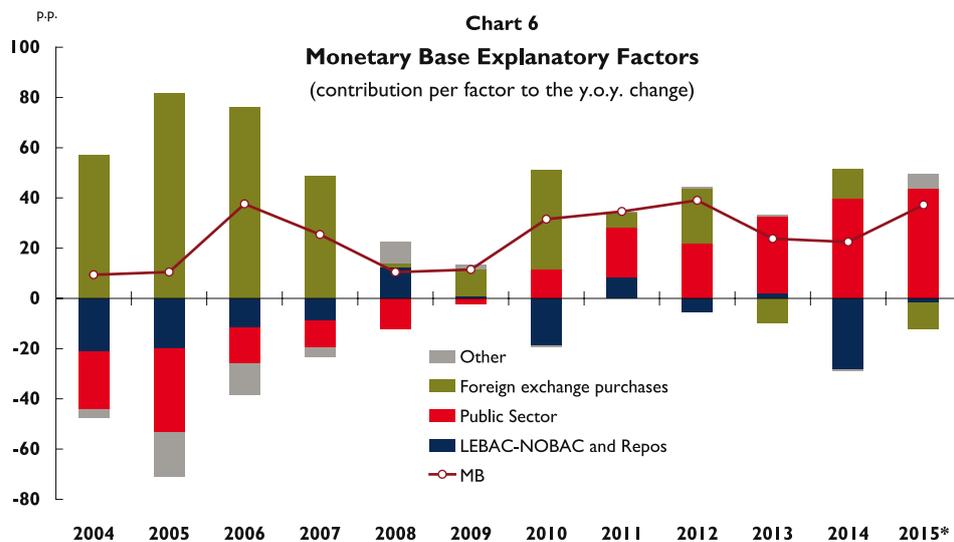


\* Arbitrage of the same bond traded in the local and foreign market. Source: BCRA

Very soon, the BCRA became a net seller of foreign currencies in the spot market and virtually the only seller in the futures market, whose dynamics began to be perceived as unsustainable.



The increasing fiscal deficit and the deterioration of external accounts found their correlation in the so-called creation factors of the monetary base. Thus, the monetary effect of the currency purchases by the BCRA in the foreign exchange market gradually lost its relevance and was finally replaced by the monetary effect of financing to the public sector, which was contractionary until 2007 (when the Treasury applied part of its primary surplus to debt service in foreign currency) and then increasingly expansionary as from 2010 (Chart 6). This process intensified as from 2012.



\*Accumulated figure corresponding to the last twelve months up to November 2015. The item "Other" includes the cancellation of rediscount or the operations related to the bicentenary credit line, purchase/sale of government securities, and gain/loss for exchange rate futures, among others. The year over year change of the MB is influenced by changes in reserve requirements.  
Source: BCRA.

## MONETARY AND FOREIGN EXCHANGE REGULARIZATION

When the new authorities took office, on December 10, 2015, the Central Bank started to pave the way for the monetary and foreign exchange regularization. In this respect, three action areas were the unification of the foreign exchange market, the regularization of the over-the-counter market transactions of the monetary authority and the rebuilding of the Central Bank's balance sheet.

### a) Unification and regularization of the foreign exchange market

In line with the priorities of the new administration, progress was made to regularize and unify the foreign exchange market, thus establishing one single exchange rate for all types of transactions, and to release the flow of current transactions, with minimum restrictions in place for capital transactions and external operations made before the unification.<sup>5</sup> The obligation of settling exports in the foreign exchange market was kept while the purchase of foreign currency for the formation of foreign assets was authorized for up to US\$ 2 million per month for both natural and legal persons. Likewise, a schedule was established to regularize pending payments of imports already shipped. As an alternative to such schedule, the Treasury issued a bond it will pay as from May next year.<sup>6</sup>

In addition, and with a view to creating a sounder position to implement the managed float policy in the foreign exchange market, the partial conversion of Chinese yuan

<sup>5</sup> Communication A 5850.

<sup>6</sup> Joint Resolution by the Secretariat of Economy and the Secretariat of Finance 7/2015 and 3/2015.

corresponding to the currency swap arranged between the BCRA and the Central Bank of the People's Republic of China was agreed upon. As a result, on December 22, around US\$ 3.09 billion entered into an account in dollars held by the BCRA, equivalent to 20 billion yuan.<sup>7</sup>

It is worth mentioning that, in the days immediately after the announcement of the foreign exchange unification, the Central Bank let the market freely set the exchange rate parity for foreign currency trading in the country, without any intervention in market transactions. Simultaneously, international reserves started to experience a renewed upward trend, exceeding US\$ 25 billion at the time this document was prepared.

*b) Changes in the auctions of BCRA's securities*

In order to favor the supply of foreign currency and simultaneously diversify the supply of investment instruments in pesos, the LEBACs in pesos adjusted by the benchmark exchange rate were relaunched.<sup>8</sup> The exporters settling income on advanced payments or pre-financing of exports may then buy these securities, which were rendered more liquidity by removing the limits to their secondary transfer and shortening the term as from which they can be sold to the BCRA.

In order to capture savings in foreign currency, some changes were announced in the procedure to auction LEBACs in dollars, leading to the elimination of pre-determined interest rates and their relationship with the availability of deposits in dollars, and also leading to an expansion of the universe of potential participants. Moreover, the possibility of underwriting NOBACs in dollars of up to 3 years was added (even if this instrument is not used later on).<sup>9</sup>

In the auction of LEBACs in pesos, some changes were also introduced, such as the elimination of the pre-determined rate segment.

In the days prior to the unification of the exchange rate, increases in the interest rates were established, which reflected the conditions of the monetary market. The increase in the cut-off interest rates was accompanied by a broader range of terms, with securities maturing as from 35 days.

In addition, the limits then in force on lending and borrowing interest rates were also removed. As from December 17, transactions are made at the interest rates freely agreed between the financial entities and their clients. From then on, part of the increase of LEBACs' interest rates was passed on to the interest rates paid for time deposits. In this context, time deposits in pesos, from both the wholesale and the retail segments of the private sector, reversed the declining trend they had exhibited in the first fortnight of December.

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<sup>7</sup> Press release P50675.

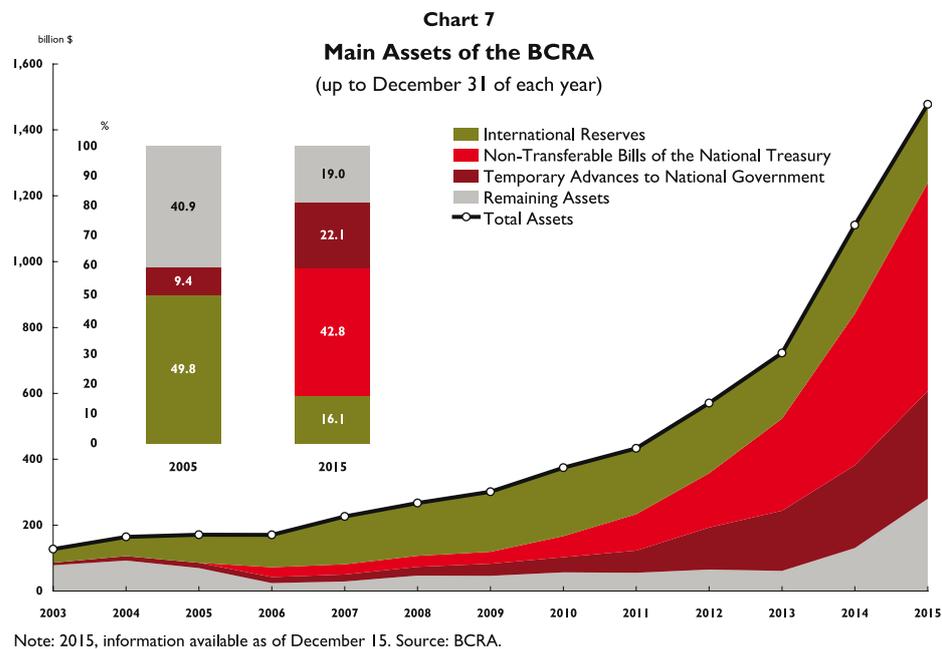
<sup>8</sup> Communication A 5854.

<sup>9</sup> Communication A 5855

c) *Strengthening of the BCRA's balance sheet*

The policies implemented by the Central Bank in recent years have also impacted on its net worth position. The strong expansion of its assets was accompanied by a marked deterioration of their quality, entailing a serious limitation to the fulfillment of its targets.

The share of international reserves in the assets of the BCRA went down sharply, from 50% in 2005 to 16% in 2015 (Chart 6). The counterpart of this reduction was the financing to the Public Sector, which was mainly instrumented through Non-Transferable Bills.



In this sense, the recent swap of three Non-Transferable Bills of the National Treasury (one of them issued in 2006 and the other two in 2010) for the sum of US\$ 16 billion for new issues of BONAR 2022, BONAR 2025 and BONAR 2027, entail an important improvement for the Central Bank's balance sheet. The instruments that will be part of the assets of the Central Bank are BONAR 2022 (33%), BONAR 2025 (33%) and BONAR 2027 (34%). The first instrument will pay a 7.75% coupon and the other two, 7.875%. This is a replacement of entirely illiquid assets with other that may be traded in the financial markets. Thus, the Central Bank is strengthening the instruments available for the implementation of its monetary and exchange rate policies.

## TARGETS AND PROGRAMS FOR 2016

The priority target of the Central Bank will be price stability in the Argentine economy.

Section 3 of the Charter lays down a series of targets to be fulfilled by this Institution through the actions it will pursue. They are not ordered according to an alphabetic criterion; instead, they are expressed following an order of preeminence or importance. Therefore, on the basis of this Section, it is evident that the essential mission will be to watch over the monetary stability of the economy, resulting in measures and policies focused on ensuring the gradual decrease of domestic inflation rate. Price stability will be the main priority among the Central Bank's targets.

During the period of regularization after exchange rate unification, recovery of monetary instruments and strengthening of its balance sheet, the Central Bank already started to make monetary policy decisions tending to a decreasing inflation rate.<sup>10</sup> This will continue to be its policy in the first months of 2016. The release, already announced, of a new price index in 2016 will allow for rendering the BCRA's inflation guidelines more explicit.

In order to meet the above-stated targets, the Central Bank will mainly resort to the interest rates of its own securities and of reverse repos as fundamental instruments for monetary regulation. On the basis of the inflation dynamics observed, the Central Bank will seek to determine an evolution of the monetary aggregates consistent with the intended performance for domestic prices.

Movements in the real demand for money, especially those related to the recent reinstatement of the free conversion of the peso, make it difficult to establish explicit targets for monetary aggregates. However, given that in the months prior to the beginning of this administration high monetary issuing rates were recorded, the Central Bank will seek to decisively reduce the expansion pace of the amount of money, both significantly and quickly, since these issue levels are inconsistent with the targets set by this Institution for the coming years.

On a regular basis, the Central Bank will inform the position of its authorities regarding the inflation dynamics being observed, as well as the policy measures it will adopt accordingly.

Specifically with reference to the exchange rate policy, the Central Bank will implement a floating exchange rate regime, which provides some flexibility to face shocks caused by adverse international contexts, keeping for itself the possibility of preventing, through monetary instruments, an excessive volatility of economic nominality. The medium-term target will be to decouple, to the extent possible, the performance of foreign exchange variables from the price evolution of the domestic economy. The implementation of an

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<sup>10</sup> Press release P50679.

inflation targeting regime, together with a managed floating exchange rate regime, allows for dissociating to a large extent the performance of prices from the foreign exchange dynamics.<sup>11</sup>

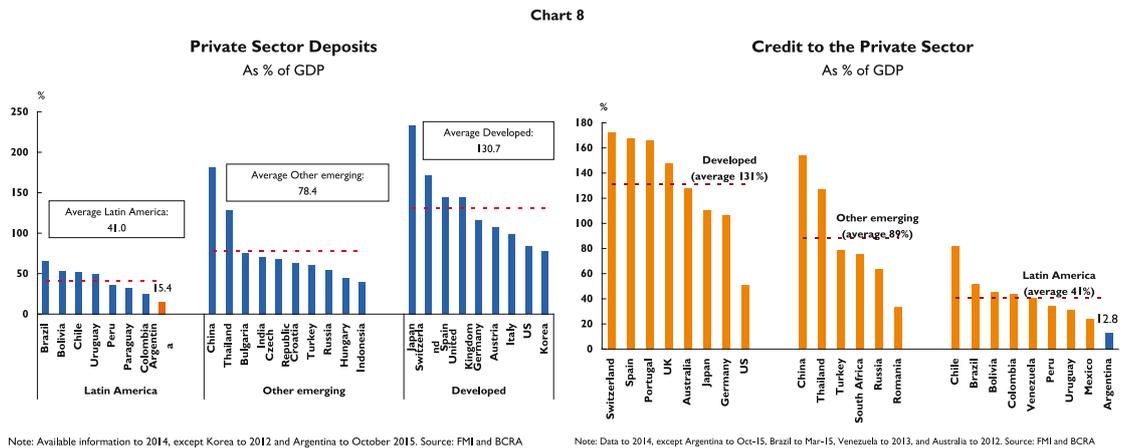
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<sup>11</sup> See, for example, Sebastián Edwards (2006), “The relationship between exchange rates and inflation targeting revisited”, NBER 12163.

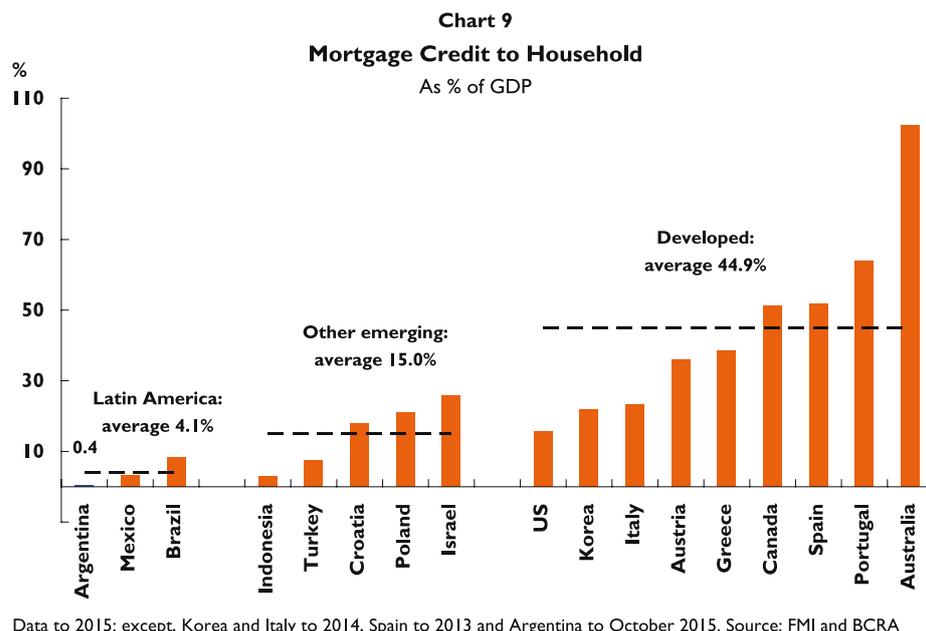
### 3 | Financial and Credit Policy

#### THE CURRENT ARGENTINE FINANCIAL SYSTEM

Currently, the domestic financial system has a remarkable development potential given its low depth in the economy. At present, it is estimated that deposits from the private sector would reach 15% of GDP, while credit to the private sector provided by the financial entities would account for less than 13% of GDP, quite below the levels seen in other economies, including those of our region.



In addition, long-term financing for residential investments is very limited.



Regarding the transactions of the domestic financial market, it has been observed that “transactional” deposits are the main source of financing, while deposits made with a genuine savings purpose are less relevant. Thus, bank funding is dominated by deposits (mainly for the short term), with a scarce share of other instruments. The stock of total deposits accounts for 73% of the sector’s total funding, the net worth reaches 13%, while the sum of corporate bonds (ON), subordinated debt (OS) and foreign credit lines account for only 2% of the total. On the other hand, bank assets mainly consist of credit to the private sector, liquid assets and financing to the public sector. Loans to households and companies concentrate about one half of total assets, liquid assets in a broad sense (including holdings of monetary policy instruments) account for one third, financing to the public sector accounts for approximately 10%, while other assets complete the total.

The reduced size of the domestic financial system is part of a broader context characterized by a low level of savings in domestic currency at banks. For example, in the last 10 years, the stock of deposits from the private sector in domestic currency increased by an amount equivalent to US\$ 59 billion (at the official exchange rate), while the formation of freely available foreign assets of this sector exceeded US\$ 71 billion in the same period. In plain words, the economic players did not choose to channel their savings through our financial system.

In December 2015, a set of measures was introduced to accompany the regulatory changes related to the foreign exchange market and aimed at endowing the sector, once again, with a capacity for growth. In particular, the BCRA decided to eliminate the limits to interest rates in both credit transactions and time deposits and investments.

In the case of financial intermediation –even though it stands below the desired levels–, the financial system has managed to keep broad levels of risk hedging and solvency. Likewise, currency mismatches continued to go down and this helped eliminate the danger of systemic disruptions.

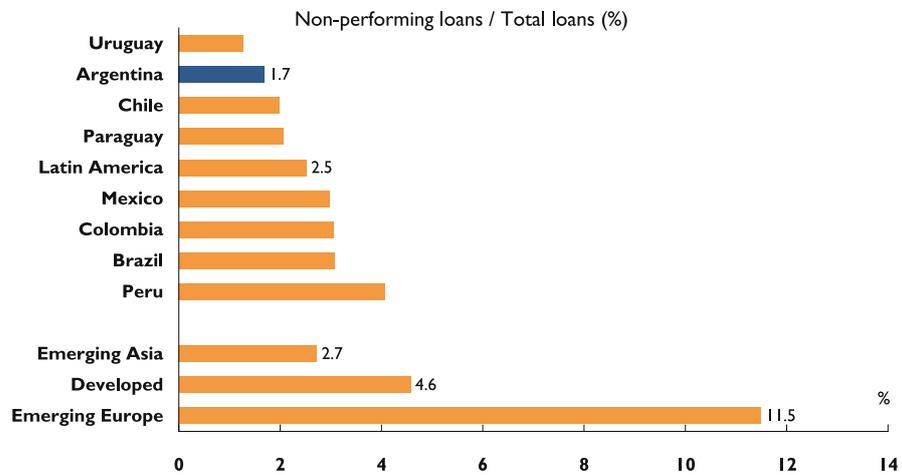
### Financial System Soundness Indicators

In %	1998 December	2003 December	2011 December	2012 December	2013 December	2014 December	2015 October
<b>Liquidity</b>							
.. (Liquid assets + Central Bank securities) / Total deposits	23.1	29.1	37.6	38.6	38.5	45.4	42.4
<b>Private sector credit risk</b>							
.. Credit / Netted assets	58.0	18.3	49.5	50.9	51.7	47.4	48.9
.. Non performing loans / Total loans	12.2	33.5	1.4	1.7	1.7	2.0	1.7
.. Provisions / Non performing loans	62.3	79.0	171.2	141.0	147.8	139.7	149.0
<b>Currency risk</b>							
.. (Foreign currency assets - Foreign currency liabilities + Net undelivered foreign currency purchases) / Net worth	83.1	71.7	42.5	43.2	71.4	21.8	27.4
.. Foreign currency loans / Private sector loans	63.4	6.7	14.3	7.4	5.0	5.0	4.6
<b>Liabilities</b>							
.. Total deposits / (Liabilities + net worth)	53.9	49.1	73.1	75.0	74.4	72.5	72.9
.. Outstanding bonds, subordinated debt and foreign lines of credit / (Liabilities + net worth)	10.7	12.8	2.4	2.1	2.4	2.5	2.5
..Net worth / (Liabilities + net worth)	11.6	11.7	11.2	11.5	12.1	12.5	13.0
<b>Solvency</b>							
.. Capital compliance / Risk-weighted assets	-	-	-	-	13.6	14.7	14.1
.. Capital compliance / Credit risk-weighted assets	20.3	14.5	15.6	17.1	-	-	-
.. ROE (12 months accumulated)	3.9	-22.7	25.3	25.7	29.5	32.7	29.7
.. Assets / Net worth	8.6	9.9	9.1	9.0	8.6	8.1	7.8

Credit risk continued to stand at low levels. This was evidenced by a 1.7% ratio of non-performing bank loans to the private sector, standing quite below the figures observed in the sector one decade ago. This delinquency rate is limited if compared to that of other financial systems of the region and of other emerging countries.

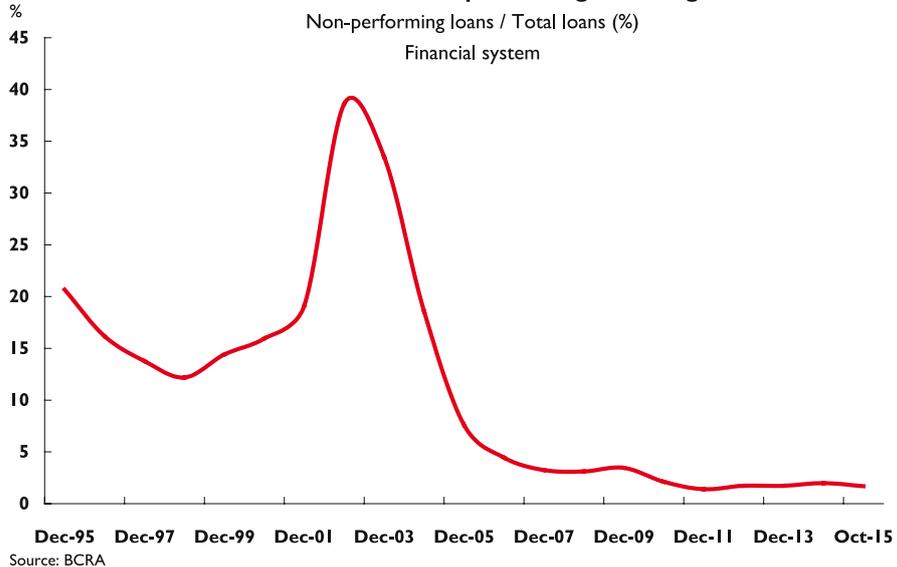
The balance of accounting provisions for the ensemble of financial entities stood above the balance of non-performing loans, within a context of low indebtedness levels and financial burden at aggregate level by both companies and households and without relevant changes in the credit standards applied by the entities.

**Chart 10**  
**Non-performing Financing. International Comparison**



\*Note: Private sector non-performing loans as percentage of total private sector financing.  
 Emerging Asia: China, India, Indonesia. Developed: Australia, Canada, France, Germany, USA, Japan, Spain and Italy. Emerging Europe: Bulgaria, Romania, Hungary and Turkey.  
 Data to 2015, except: China, Bulgaria, Germany and Italy to 2014; Uruguay and France to 2013.  
 Source: IMF and BCRA.

**Chart 11**  
**Private Sector Non-performing Financing**



Source: BCRA

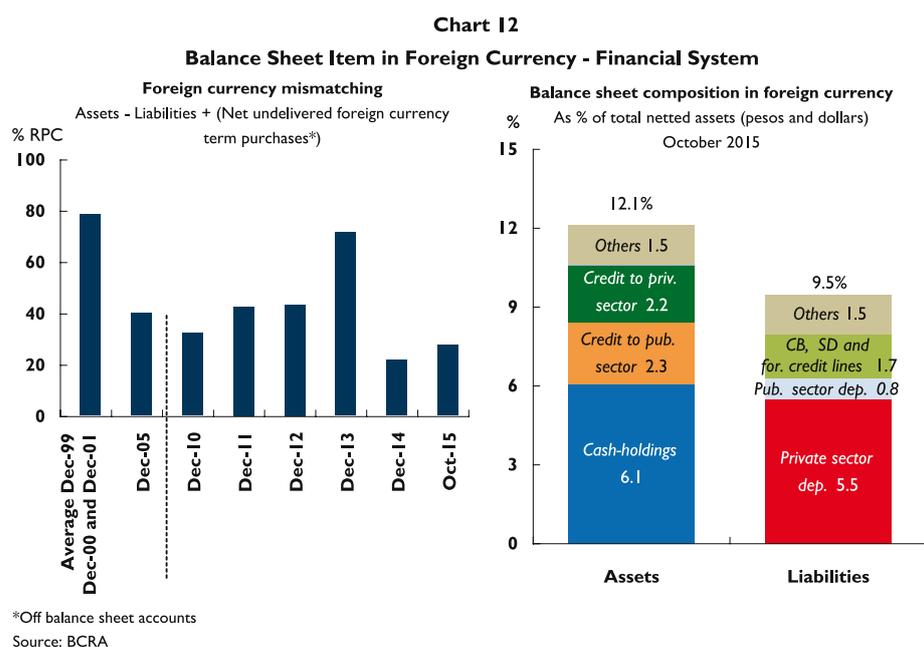
In 2015, the financial system kept a sound position against liquidity risk from a systemic perspective. In terms of the indicators of exposure to this risk, both the concentration of deposits<sup>12</sup> and the relative weight of short-term liabilities<sup>13</sup> in total funding –liabilities plus net worth– did not show significant changes in the period. In turn, even though coverage

<sup>12</sup> Considering the 160 main depositors of each entity.

<sup>13</sup> With a residual term shorter than one month.

of short-term liabilities with assets with a higher liquidity<sup>14</sup> went down slightly in 2015, the current levels exceed the average of the last five years. In line with the international standard, our domestic regulation establishes a minimum level for the Liquidity Coverage Ratio, encompassing 18 large and medium-sized financial entities that account for 85% of the financial system assets. Considering the information available for the period January-June 2015, the entities subject to the regulation comply (in excess, on many occasions) with the minimum ratio in force (60%), reaching an average of 220%.

The foreign currency risk faced by the financial system was limited due to the macroprudential regulations implemented when applicable by the BCRA, such as the regulation under which the lending capacity generated by deposits in foreign currency must be allocated to provide financing in such currency to agents whose income is related to the evolution of the exchange rate. In this context, the domestic financial system has shown in recent years a relative strength in terms of its position against credit risk derived from nominal exchange rate fluctuations.



In the first ten months of 2015, the financial system accrued profits which, in terms of its assets, accounted for 3.8% (annualized). As a result, the ensemble of financial entities would have shown positive results for 11 years. Mainly because of these results, the solvency indicators of the ensemble of entities stood at high levels. The aggregate financial system regulatory capital compliance accounted for 14.1% of total risk-weighted assets

<sup>14</sup> Defined as the combination of Liquidity compliance at the BCRA, other liquid assets, net credit balance for repo transactions of financial entities against the BCRA using LEBACs and NOBACs, holdings of LEBACs and NOBACs.

(RWA) in October and Tier 1<sup>15</sup> capital compliance (capital of a higher quality to absorb losses) reached 13.2% of RWA. In turn, the capital compliance in excess of the regulatory requirement (capital position) reached 88% in October.

#### **LINES OF ACTION FOR THE DEEPENING OF THE FINANCIAL SYSTEM**

Ultimately, the big picture could be summarized by saying that the financial system is small, leveraged in transactional deposits and has not managed to create attractive mechanisms for savings in pesos but, at the same time, it is solvent, liquid, its systemic risks are very limited and there is no currency mismatching. The situation is an ideal starting point to think about a significant growth for the sector.

As the macroeconomic situation and especially the monetary situation regularize, there will be a more favorable context for the deepening and development of the Argentine financial system and for credit expansion in real terms. The Central Bank seeks to accelerate such development with several lines of action.

##### *a) Unit of account linked to the Price Index*

Encouraging national savings in domestic currency will be one of the Central Bank's priorities. To this effect, a fundamental step will consist in the design of attractive instruments for savings in pesos for all citizens of the country. The possibility of creating a system of deposits and credits in units of account having a constant purchasing power in real terms will be properly assessed. This mechanism will render deposits in pesos more attractive relative to other current alternatives.

In turn, the Central Bank will adopt concrete measures to channel such savings towards a higher and more affordable supply of mortgages and credit for productive purposes. The establishment of rules that may facilitate loan granting under which principal is tied to an unit of account with a constant purchasing power will result in considerably lower initial installments, added to the fact that the income to be required to access such loans will be lower than it is at present, thus reducing the barriers curbing access to credit to large sectors of the population.

##### *b) Competition, transparency and optimization*

The Central Bank will seek to improve the levels of competition in the sector, even beyond the high levels it shows at present. In line with this guideline, the initiatives to be undertaken include authorization for correspondent accounts, a simplified process for the opening of branches, improvement in the efficiency levels of transaction processing, and competition optimization in the areas of insurance and armored funds & securities carriers.

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<sup>15</sup> Core capital (common stock and disclosed reserves), net of deductible accounts.

The Central Bank will ensure the fulfillment by banks of the rules protecting the financial system users. It will actively promote transparency policies and will take measures to simplify the mechanism used to inform consumers about the conditions of their financial services contracts. In the first place, it has been established that the Total Finance Charge on loans of all types must be clearly visible for users, so as to make the final price of financial transactions more transparent and make it more understandable for clients.

*c) Financial inclusion*

The operating infrastructure of the financial sector continued to expand slightly throughout 2015, even though there is still potential for improvement in the different areas of the country. The number of branches went up 1.6% in the twelve months from September 2014 to September 2015, to 4,451 branches. In turn, the number of ATMs and self-service ATMs increased 4.9%, to 19,489 units by the end of the third quarter of 2015.

New measures will be adopted to continue to deepen the reach of the financial system, providing access to basic financial products and services to the sectors of the population residing in districts where there is low or no presence of banks. The Central Bank will promote financial inclusion, encouraging the opening of new branches and installation of ATMs, and will facilitate the process for accessing banking services throughout the country. In this respect, the project for the creation of correspondent accounts will be especially promoted, since our country is lagging far behind if compared to international standards on this matter.

*d) Investment for productive purposes*

In the medium term, the development of the financial system will depend on the capacity to encourage savings and on a competitive and transparent system seeking to reach all potential borrowers. Meanwhile, the Central Bank considers that it is reasonable to channel credit towards the most vulnerable productive and social sectors. In 2016, the Bank will renew the Credit Line for Productive Investment (LCIP), promoting financial inclusion. In essence, the objective is to provide access to credit to micro, small and medium-sized enterprises (MiPyMES) at reasonable rates and for different terms, even when we know that the cost of this policy is borne by other users of the financial services. For the first half of 2016, the goal is that loans granted under LCIP reach 14% of the deposits of banks subject to the regulation.

*e) Prudential regulation*

In recent years, Argentina has developed and implemented a series of policies with a macroprudential bias seeking to strengthen financial stability conditions, which have accompanied the traditional monitoring and banking regulation tools of a macroprudential nature. All together, these tools have contributed to containing potential systemic risk episodes having their origin in both the external context –such as those related to the

international turbulences in place since the beginning of the global crisis– and in the domestic financial system if it were to undertake an excessive level of risk (high exposure to specific economic sectors, high currency mismatches, among others).

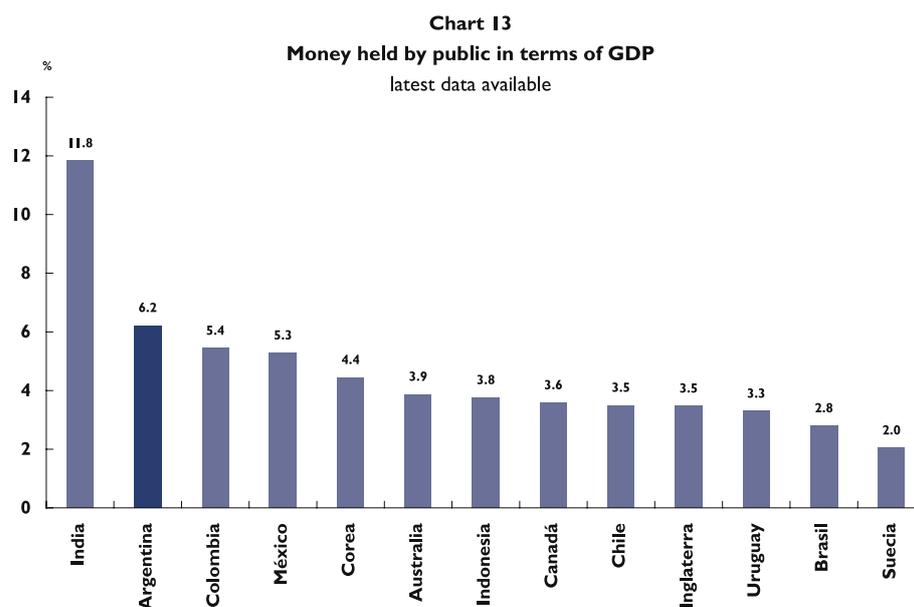
In this framework, in 2015, the Central Bank moved forward in the convergence with the international recommendations and standards related to banking regulation and aimed at strengthening financial stability, including: a. the implementation of regulatory frameworks on additional capital buffers (including conservation, domestic systemically important banks [D-SIBs] and countercyclical capital buffers); b. the establishment of the Liquidity Coverage Ratio; c. the introduction of the information requirement on the Leverage Coefficient of the entities; d. progress in terms of the International Financial Reporting Standards (IFRS); e. improvements in the capital requirement for credit risk (clearing houses); f. monitoring of the Net Stable Funding Ratio (NSFR); and g. adequacy of the capital requirement for market risk according to Basel recommendations.

The work agenda for 2016 also includes the completion of the implementation of principles for an effective risk data aggregation and reporting, progress in our developments under the framework of the IFRS, as well as adjustment to the banking regulation international standards which are yet to be defined under the Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB). In this context, during the first half of 2016, the BCBS will assess the domestic implementation of the international standards on regulatory capital and bank liquidity. The participation in these regular evaluations is a commitment undertaken by all BCBS members, as established in the Charter of the Committee, thus contributing to ensuring that Basel standards are correctly and timely brought into the regulation of the member jurisdictions.

## 4 | Bankarization and Means of Payment

One of the core policies of the Central Bank consists in promoting bankarization, understood as the universal access by the population to payment, credit and savings services under conditions that reduce transaction cost to a minimum, maximize financial intermediation, and scale down the underground economy.

In particular, and in relation to the means of payment, Argentina still has a comparatively high use of cash, added to the inconvenience that inflation was not accompanied by an increase in the denomination of bank notes. The Bank has defined a short-term agenda and a medium-term agenda to minimize transaction costs and to reduce the shadow economy.



Source: BCRA based on each central bank, statistical offices and GMM.org

### *a) Short-term: new family of bank notes*

In the short-term, the characteristics of the cash held by the public will be reshaped, through the issue of a new family of bank notes including higher-denomination paper money, due to the urgent need of facilitating the transactions made by the public and reducing the currently excessive operating costs inherent in monetary issue.

*b) Medium-term: minimizing the use of cash held by the public*

The medium-term agenda will seek to minimize the need of using cash by the Argentines. Some progress has already been made in this area, but this progress needs to be consolidated and accelerated.

Throughout 2015, the amount up to which electronic transfers have no cost for the users has been raised and the scope of transfers with instant crediting has been widened. In addition, the maximum crediting amounts and maximum balances in the Universal Free Bank Accounts (CGU) have been raised up to an amount equivalent to four times the Minimum Vital and Adjustable Salary (previously \$ 10,000).

The goal of the Central Bank will be to decisively promote bankarization in the economy, with a view to achieving higher levels of formal economy and hindering any illegal activities such as drug-trafficking and money laundering. Measures will be implemented to digitalize transactions, reduce the use of paper and consolidate electronic communication with users, added to initiatives tending to achieve a higher degree of security, agility, efficiency and competition in the transactions of the Payment System, while encouraging the use of new technologies for means of payments.

Along 2016 and regarding Payment Systems, progress will be made to create a Retail Payment Integrated System. To this effect, guidelines were drafted in line with the international standards, including open access interoperability for payment services providers, the integration of payment operations with a view to reducing costs, and the definition of the participants and their roles.

A mechanism will be developed jointly with payment system providers to make purchase & sale transactions of registered assets, improving their security and transparency and tending to reduce the use of cash.

With a view to promoting bankarization and the use of electronic means of payment by the population, the Bank will implement, among other measures, the use of the electronic check, for which a change to the Checks Act will be proposed. The idea is to create a legal framework to facilitate the creation and circulation of a message sent through electronic means whereby a pledge to make a payment is made, with or without reserve of funds, which may also be subject to judicial executory proceedings if applicable, traded at the stock exchanges, and effective as to third parties.

On the other hand, the overall adoption of the smart phone is ready to be massively intensified in the next years. Providers of mobile money may significantly improve their current supply of services for users by introducing enriched user interfaces and features.

# Annex I | Inaugural Address and Management Guidelines by the Governor of the BCRA

Good morning.

We are living new times and I would like to start my term of office by telling you the ideas and principles under which I hope we will work all together. As Javier Cercas states in “Anatomía de un instante” (Anatomy of an instant):

There is little else that may discredit us as a society than practicing false ethics which “instead of worrying about what it really corresponds to a politician, the future and the responsibility for such future, gets lost in issues [...] about the guilt over the past [...] overlooking the inevitable falsification of the entire problem, which results from the rapacious interest of winners and losers for getting moral and material advantages from the guilty plea of others...” [1].

The spirit with which we will tackle this management lies in the future, rather than the past. This is how we have to face the current times. As stated by President Mauricio Macri on the evening of his electoral triumph, the country cannot get stuck in revenge and score-settling. The energy needs to be focused on the future, on building the future we all want for the country and our children.

On the basis of this spirit, I would like to describe the lines of work we will follow from now on. In other words, in this first message I will define the strategic lines of the Central Bank of Argentina which I have the honor to have been elected to preside over.

I want to take this opportunity to make some reflections on the fundamental guidelines which will underpin my work inside this institution. Some years ago, I led the transformation of one of the entities of this system: Banco Ciudad. There, we worked, essentially and successfully, on the reconstruction of the pride of belonging to such an important public entity. This is why I would like to talk first for a few minutes about the challenge of strengthening the pride we should all have of being part of this entity, which is undoubtedly one of the most relevant in the institutional fabric of the country.

In order to define this challenge, it is worth starting with our Charter, which in Section 3 sets the targets of our institution:

*“The purpose of the Bank is to promote –to the extent of its powers and within the framework of the policies set by the National Government– monetary stability, financial stability, employment, and economic development with social equity.”*

How this Section has been drafted is highly interesting. This list does not follow an alphabetical order but, rather, an order of preeminence or importance. As a result, the Charter tells us that monetary stability is the main target of this Central Bank. Above all, this means having a low inflation rate or, in other words, a reliable currency. It also means having a predictable inflation and a freely convertible currency. When the President asked me to take over this position, he stated that “we are going to renew our vote of confidence” and said that my main mission would be “to give the Argentineans their currency back” and “to respect the independence of the Central Bank.” The purpose of the President is well guided since he is asking us to do precisely what our Charter requires from us.

Lucas Llach, Deputy Governor of the Bank, has an interesting way of expressing this same concept. He says: “The government has several creditors: transferees, employees, suppliers and providers, debt holders, etc. But we must understand that the holders of pesos are also creditors of the State. People use their work and effort to purchase the means of payment required to live. And our institution watches over these creditors and it has the obligation to protect them. The holders of pesos have remained unprotected for too long. And it is from the perspective of such creditors that we must think about our role.” In short, this means that this institution will mainly focus on strengthening our currency, and this entails having an inflation rate in line with the international standards.

To reinforce this concept, I state that this institution will pay more attention to the evolution of inflation than to the price of the US dollar which, in recent times, has become an obsession, precisely because the focus was not on the real problem. Taking care of the value of our peso means ensuring that inflation is low rather than ensuring that the dollar does not move. The amount of dollars we can buy with one peso should not be our concern; what we must do is protect the purchasing power our pesos have in goods. Our “reaction function,” as usually stated in academic papers, must respond to changes in price evolution rather than necessarily in the US dollar evolution.

This change in the main focus requires the adoption of an inflation targeting regime with a managed float exchange rate. We will resume the task that our current Minister of Economy and Finance had to leave unfinished in 2004.

After the initial step in the regularization of our foreign exchange market, we will quickly start to define the framework, targets and time which will guide our transition towards an inflation rate in line with that of most countries around the world. This will be the unwavering target of this institution.

Now, I will refer to the exchange rate regularization plan, commonly known as “the end of the currency clamp.” We should not stop here for too long. The currency clamp is an anecdote, because a country cannot work if its economic activity is stuck, as this has occurred for the last 4 years. As from the adoption of the currency clamp, the economy has stopped growing. Some people think it has served to curb the demand for dollars. I think that, in fact, what it really did was to destroy the supply of currencies. This is why

we have to abandon this trap and do it immediately. In addition, it is worth remembering that a float regime, even though managed, will allow us to recreate the conditions for our economic growth. Some years ago, in a paper I wrote with my colleague Eduardo Levy Yeyati, which was published in the American Economic Review, we showed that countries with more flexible exchange rate regimes had recorded, as from the abandonment of the Bretton Woods system, higher growth rates than those with more rigid exchange rate regimes [2]. A system based on inflation targets and a floating exchange rate will be the goal of our country's monetary policy.

Let's leave for one moment the nominal arena and stop at what we call "real exchange rate." As we all know, it reflects the productivity levels of an economy.

The Swiss franc has a high purchasing power because the Swiss economy is remarkably strong and has very high levels of productivity. Instead, a weakened and inefficient economy, which has no productivity, requires a more depreciated exchange rate to offset its internal inefficiency, as proven by the Balassa-Samuelson theory. There are no shortcuts: to strengthen our peso we have to strengthen our economy. It is important to have this relationship in mind. In general, the experiences of protracted overvaluation of the local currency have not been positive, not only in Argentina but also internationally [3] [4]. This is why, in so far as it is allowed by the price stability target, this Bank will seek to preserve a competitive exchange rate. Specifically, we will not hesitate to prevent the inflow of short-term capitals from appreciating our exchange rate beyond what it is reasonable. It is worth including a footnote here on inflation measurement. I want to tell you that, fortunately, a past where reality was concealed behind invented statistics is definitely over in Argentina. This was a stage where the option was to deny reality rather than face it. A maddening stage where what was white was said to be black, and vice versa. And we wasted our energy discussing if it was white or black, instead of devoting such energy to solving the problems in hand. As a governmental definition, our institutions and officials will never again exercise such practices and will always tell the truth. This is a core definition for an institution like this one, since it lives by the signals it sends and the trust it builds.

Let's go then to the second item of Section 3 of our Charter: financial stability. The emphasis on this item as the most relevant after price stability is correct. Because this is the channel for the Central Bank to contribute to the last target: economic development with social equity. We must say this clearly and openly: having bastardized the peso has not allowed us to create savings instruments in pesos and without savings there is no credit and without credit there is no progress. When I was working at Banco Ciudad, officials and employees were really happy at working for a financial entity, because financial entities create "term" in financial assets. In other words, they turn typically short-term liabilities into long-term assets. Banks create time, they give us time. And these long-term assets allow families to buy a house, or the owner of an SME to grow his/her business or a large company to invest in projects that may transform the economic matrix of the country. But, naturally, without currency there are no savings, without savings there is no

credit, and without credit there is no development. In addition, without a sound financial system, there is no equity in distribution because only those who already have money may invest, thus sustaining the old structures and undermining the momentum of the upward social mobility processes. This is where we are. We have a transactional financial system, i.e. a system that holds the money we need for our transactions and lends any surplus of this money. This is a lean financial system, the deposits and credits of which account for 16.8% and 14.0% of GDP, respectively, while in Chile, for example, they account for 66.8% and 74.4%.

Consequently, it is evident that this is a topic to work on. And of course, it starts with the first point: recovering the strength of our currency. We can help go along this path at a faster pace. For example, we should assess the possibility of having a system similar to the Chilean “Unidad de Fomento,” a mechanism launched when they had inflation levels similar to ours and which has allowed them to build the financial system they currently have, six times larger than ours. We must think that only in mortgages, Chile has one and a half times our financial system, in GDP terms.

A mechanism of this sort allows banks to receive money, the real value of which will be preserved for the depositor. With such an instrument, we will tend to forget about the dollar as a savings tool, since it has a much more uncertain value and a limited potential to make a positive contribution to the economy. We want to see the savings of the Argentines translated into mortgages and loans for productive purposes, fostering economic growth, rather than dollars in a can or in a safe deposit box. We must recover the culture of savings and transmit it to our children. We will be responsible for regulating how such savings must be lent by banks. Just to give an example of its implications, it is worth remembering that it will make true the old yearning that the installment of a mortgage is lower than the value of a rent. In an example I will permanently repeat, a mortgage loan with an interest rate around 1% in unit of account might result in a 30-year loan with an installment similar to, or even lower than, that of a rent. In concrete terms, for a loan of \$ 750,000, the monthly initial installment would stand around \$ 2,211 and the household income required would be \$ 7,371. This means that the dream of becoming owners of our own house would be at reach for everyone very soon.

After increasing its raw material, i.e. savings, and aiming at doubling them in size in the next five years, the agenda related to the financial sector also includes improving its levels of competition. I have personally verified that the financial sector is very competitive, but we have to encourage it even more. Because competition is the only guarantee we have that it is working properly and fully in favor of people. The authorization to open correspondent accounts and bank branches, the improvement of their efficiency in transaction processing, the access to credit instruments such as loans debited directly from payroll by all those who may act as intermediaries and also improving the competition of the sectors related to insurance and armored funds & securities carriers are some of the steps to be followed.

By improving the quality of our financial sector our institution will contribute to development. It has been widely thought that this organization would help development by creating money, either for credit or simply for the expansion of aggregate demand. But the idea that money creation per se will contribute to development has taken us in the wrong direction. Examples abound, both in our own and in other economies. Instead of focusing on the last four years of high inflation and absence of growth, we might remember the dramatic and long period between 1975 and 1990 when Argentina had its highest inflation records and its longest economic contraction. When that period started, in 1975, we had an income similar to that of Spain and by 1990 that income had fallen to 46.8% of that value. I remember that, back then, a taxi driver told me: “When will the government learn that you cannot make money with money?”

That view is paradoxical since it is just the opposite of the view we deem to be correct. It is low, rather than high, inflation which will create growth. Because an excessive increase of monetary issue gives rise to inflation, and then the resources launched to the system become a tax financed by the State without a final impact on aggregate demand. And, in general, as I stated before, economies with high and bad taxes tend not to grow as expected. On the contrary, a low inflation tends to create a business environment that fosters a genuine wealth creation.

Improving the transparency of the sector and simplifying the way in which prices are communicated to the clients are all elements of the agenda, within the framework of preserving one of the great achievements of this institution and of the country in recent decades: a prudential regulatory system of our financial sector that has managed to fend off the risks of a systemic crisis in the sector.

In this sense, the agenda will focus on extending the financial sector to the population as a whole, which is one of my main projects. Some years ago, Banco Ciudad, together with Banco Santander, pioneered the opening of branches in marginalized areas. We must ensure that the financial sector reaches every corner of our country and every citizen as well.

Lastly, a third item of the agenda is related to the means of payment. In the short term, we should rethink perhaps the characteristics of the cash held by the public, since we have had the same denominations for many years already, despite the fact that prices have more than ten-folded.

But the true agenda is that we contribute to bankarization, which results in the reduction of the shadow economy. Ideally speaking, we would tend towards an economy without cash, which may be a remote objective but it is also a clear goal ahead.

Because an economy without cash held by the public is an economy where it is more difficult for corruption, informality, tax evasion and drug-trafficking to operate. An economy with a high bankarization is fairer because the reduction of shadow economy leads to a more equitable distribution of the tax burdens, reducing them for the benefit of all citizens.

We have an agenda here because there is a revolution in terms of means of payment around the world. Today we live with a device in our pockets serving as cell phone, supercomputer or POS net. We must work to allow people to open a bank account from their mobile phones, or to be able to send money to their relatives in other countries from home. Means of Payment must be the management office that will launch us towards a more efficient and fairer future. We have a hard work to do here, full of ramifications, such as consolidating as a practice the electronic communication with clients, eliminating paper and contributing to the preservation of the environment.

I want to close with some reflections I made at the beginning. The sense of pride. As I said before, this was a clear goal while I worked at Banco Ciudad, starting with details that were symbols such as staying at an ATM that was not working until it was repaired, because an organization cannot afford forgetting its goal, i.e. serving the client back then, and not doing it well. That is why measuring customer service quality, improving the quality of the physical spaces or tweeting back an angry client were all elements of an agenda related to that goal of recovering the pride of being part of that institution.

I have arrived at the Central Bank with great enthusiasm but great humbleness. I am aware of the huge human capital of this institution. I will try to respond to you with work, passion and dedication.

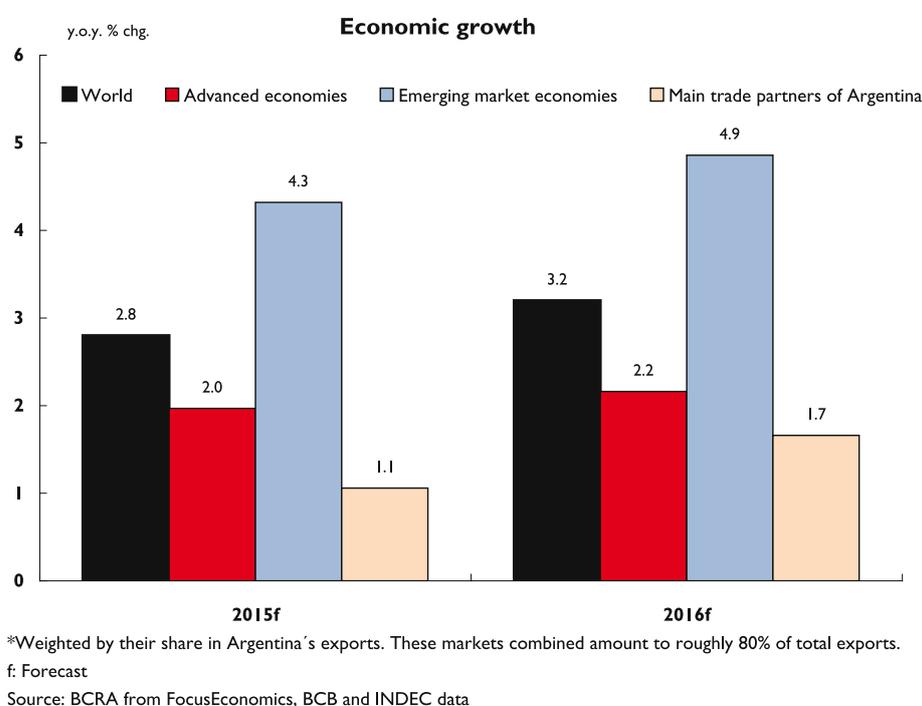
To conclude, I want to say that I know that in recent years many people may have felt that favoritism and cronyism prevailed over effort and professional quality. We are here to establish the opposite. We believe in meritocracy and we know that you also believe in it. We will prioritize career personnel and we will give them more and better opportunities for progress and development. Meetings will start at the time agreed upon, because respect starts by respecting other people's time. And, under these parameters, we will jointly defend the objectives defined, and as soon as we achieve the goals of low inflation, a strong financial system and a fairer country, we will feel prouder to state that we are part of a professional Central Bank that provides excellent services to all Argentines.

Thank you all very much. I wish you a good day. Let's start working right now to build that future together.

- [1] Javier Cercas (2009): *Anatomía de un instante*. Editorial Random House Mondadori, p.109.
- [2] Levy Yeyati, E. y Sturzenegger, F. (2003): “To Float or to Fix: Evidence on the Impact of Exchange Rate Regimes on Growth.” *American Economic Review*, 93(4): 1173-1193.
- [3] Eswar S. Prasad & Raghuram G. Rajan & Arvind Subramanian (2007): “Foreign Capital and Economic Growth,” *Brookings Papers on Economic Activity*, Economic Studies Program, The Brookings Institution, vol. 38(1), pages 153-230.
- [4] Levy-Yeyati, Eduardo & Sturzenegger, Federico & Gluzmann, Pablo Alfredo (2013): “Fear of appreciation,” *Journal of Development Economics*, Elsevier, vol. 101(C), pages 233-247.

## Annex II | International Macroeconomic Context

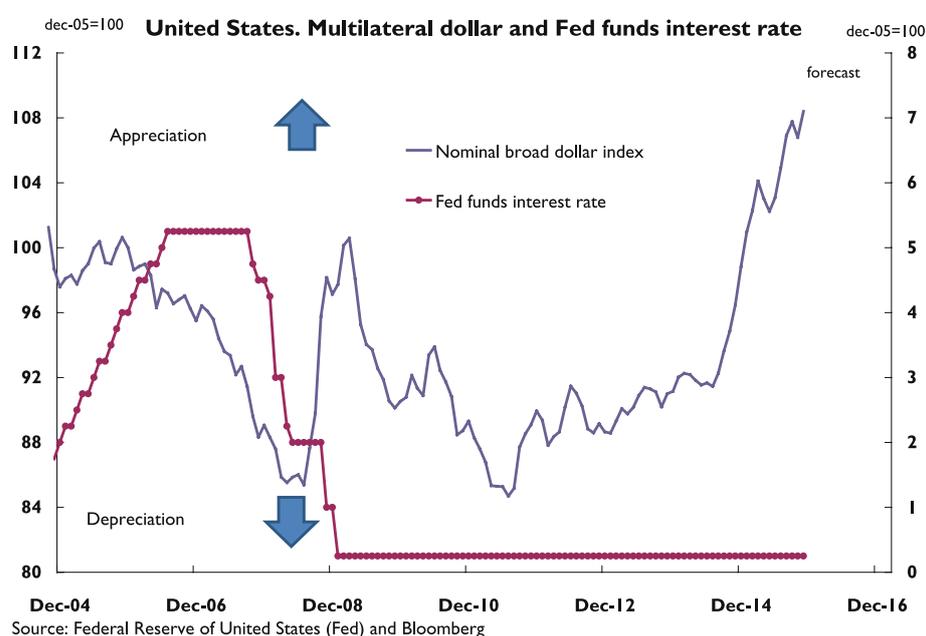
For 2016, a 3.1% expansion of the global economic activity is expected, up 0.3 percentage points (p.p.) against the growth pace that would be recorded in 2015.<sup>16</sup> Emerging countries would mainly account for this acceleration of economic expansion, with a growth forecast close to 4.7%. Meanwhile, advanced countries would keep the current momentum and their level of activity is estimated to grow 2.1% during 2016.



Argentina's main trading partners would grow 1.7% in 2016, thus increasing their pace against 2015 figures (1.1%). Brazil's GDP would contract once again (-2.8%), even though its rate of decline would drop against 2015 when its activity level would have fallen around 3.7%. In turn, China would experience a slight deceleration (+6.3% vs. +6.5% in 2015). In turn, our advanced trading partners would keep their current momentum: the United States would continue to exhibit a better performance relative to other developed economies, with an estimated expansion of 2.5% (similar to that of 2015), while the pace of recovery of the Euro Zone would continue to be limited, with a growth rate around 1.7% (up 0.2 p.p. against the 2015 increase).

<sup>16</sup> Updated forecasts from FocusEconomics (Dec. 2015), using market exchange rates.

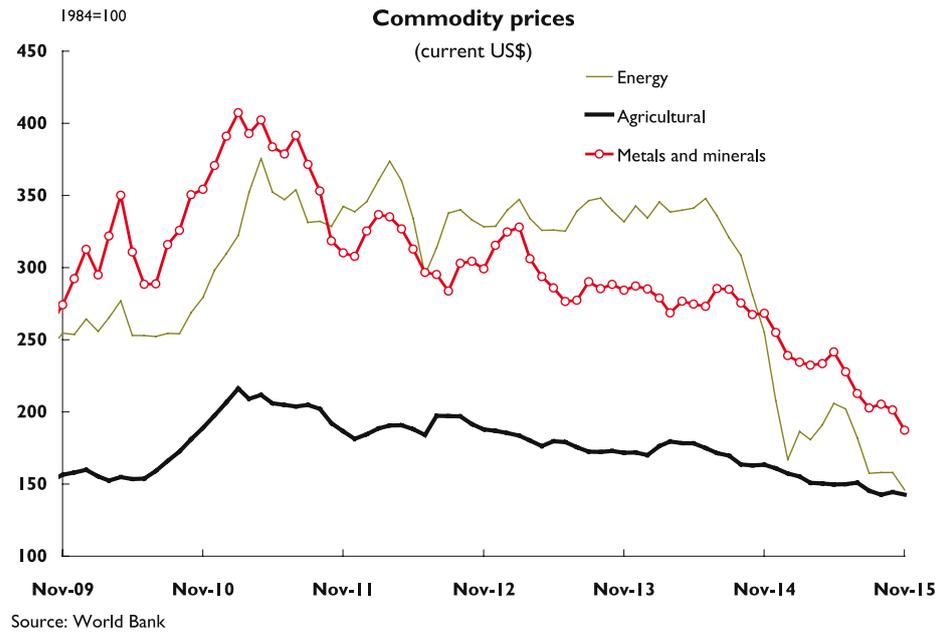
Vis-à-vis a forecast of a better relative performance of the United States against other advanced countries, then the divergences among monetary policy measures by the central banks are expected to deepen along 2016. While market expectations are signaling that the US Federal Reserve will continue with its benchmark interest rate rise cycle during 2016, new expansionary monetary policies by the Bank of Japan and the European Central Bank cannot be ruled out as a response to the low growth pace and the reduced inflation levels of these economies. Nevertheless, a context of low interest rates worldwide is expected to remain despite the perspective of a long monetary policy contractionary cycle by the US FED.



The different biases in monetary policy among advanced economies might result in a new and widespread appreciation of the US dollar, keeping the trend observed since mid-2014. The counterpart of the divergent monetary policies might entail a higher volatility among the currencies of emerging and advanced economies and among the prices of the currencies of developing countries. This would increase property and financial risks of countries that are net debtors with a high exposure to appreciating currencies and would continue to exert downward pressures on the prices of commodities expressed in US dollars.

Specialized analysts' forecasts and the implied prices of futures markets anticipate that, in 2016, commodity prices will stand around the values recorded by the end of 2015, and even though they might show a slight rebound, their prices would still go down next year. In addition to the trend observed towards an appreciation of the US dollar, the significant drop of the oil price in recent times stands out among the factors (common to all products) that would exert a downward pressure on prices since, because of its

widespread use as productive input, would contribute to a downward bias on prices.<sup>17</sup> The markets involved in the production of both industrial commodities (energy, metals & minerals) and agricultural products show an oversupply that finds its origin in the high production levels. In the case of energy, metals & minerals, there is also a weak demand due mainly to China's economic deceleration, which explains why the decrease of these prices exceeds that of agricultural products.



In this context, and vis-à-vis the significant drop in the prices of Argentina's main export agricultural products along 2015, the average of such prices would experience a new reduction in 2016 against the records of the year before, except for corn, the price of which is estimated to go up. According to futures contracts made by late December 2015, this reduction is expected to be 5% year-on-year (y.o.y.) approximately in the case of soybean, down to a value equivalent to US\$ 330/ton, and 3% y.o.y. in the case of wheat (US\$ 180/ton). In turn, the price of corn would stand 3% y.o.y. above the levels of 2015 (US\$ 150/ton). Anyway, it is worth mentioning that Argentina's terms of trade continue to be reasonably high from a historical perspective.

There are, however, some risk factors that would impact adversely on world growth, moving away from all forecasts. In the first place, an increase in the international interest rate is very likely to continue, and this implies a higher external financing cost for emerging countries, even though it would not mean a sharp change in the conditions of access to such financing.

<sup>17</sup> It is worth mentioning that the drop in the international price of crude oil has a positive impact on the external sectors of the economies that are net importers of energy, such as Argentina.

In the second place, there are risks related to international financial stability and potential corrections in the asset prices at global level (prices of shares, government securities and real estate in certain advanced and emerging economies), that might result in significant financial tensions. This is due, in part, to the fact that it is impossible to determine whether the prices of the financial assets have already discounted this estimated context of interest rate rise or if that path will imply new corrections. Lastly, potential sharp changes in the international prices of commodities –especially, oil– or in the speculative positions in commodity-related financial markets might increase volatility in global markets.