

Monetary Policy Report

January 2018



BANCO CENTRAL
DE LA REPÚBLICA ARGENTINA

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Preface

As established in its Charter, the goal of the Central Bank of Argentina “is to promote monetary and financial stability, employment, and economic development with social equity, to the extent of its powers and within the framework of the policies implemented by the National Government”.

Without prejudice to the use of other, more specific instruments for complying with the rest of its mandates –such as financial regulation and oversight, exchange market regulation, and innovation in savings, credit, and means of payment instruments–, the main contribution that the monetary policy may offer to fulfill the monetary authority’s mandates is to focus on price stability.

When inflation is low and stable, financial entities are able to better estimate their risks, which ensures higher financial stability. Moreover, higher predictability allows producers and employers to create, endeavor, produce and hire, which fosters investment and employment. Lastly, low income families may preserve the value of their income and savings, which enables economic development with social equity.

The contribution of low and stable inflation to these objectives is never as evident as when it does not exist: the flight from local currency may disrupt the financial system and lead to a crisis, the destruction of the price system hinders productivity and genuine job creation, the inflation tax hits the most vulnerable families and brings about redistribution of wealth that favor the most affluent segments of society. Low and stable inflation, on the other hand, prevents all of these problems.

In line with this vision, the BCRA has formally adopted an Inflation Targeting Regime, effective as from January 2017. As part of this new regime, the BCRA now releases its quarterly Monetary Policy Report. The report’s main objectives are to communicate to the society the BCRA’s perspective of the recent inflationary dynamic and its projection of price evolution, as well as to explain in a transparent manner its monetary policy decisions.

Autonomous City of Buenos Aires, January 22nd, 2018.

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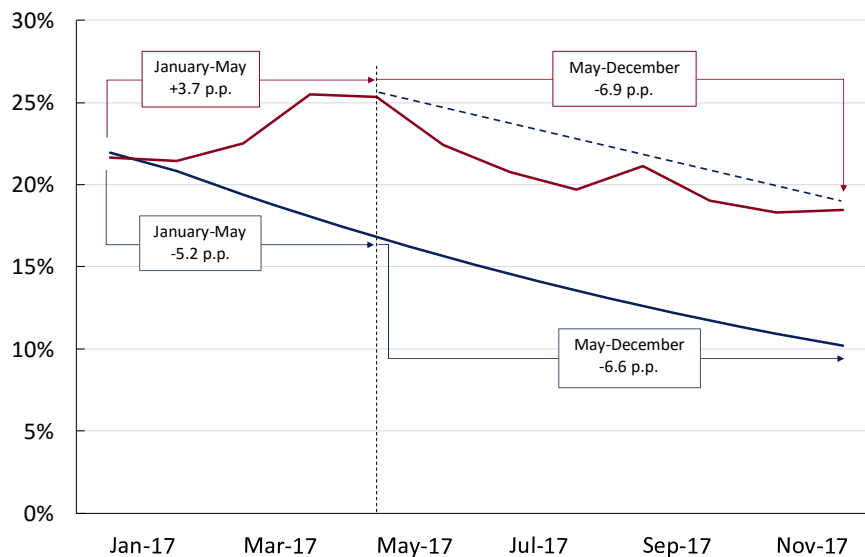
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1. Monetary Policy: Assessment and Prospects

In 2017, inflation decreased as the economy cemented its growth. Year-over-year inflation fell approximately 12 percentage points (p.p.), while regulated services' fees were updated and the real exchange rate remained stable. The growth in the gross domestic product (GDP) points at an expansion of approximately 3% in 2017, with five consecutive quarters of annual growth of 4%, with no suggestions of deceleration. Investment is leading the cycle, supported by consumption, which is estimated to grow at a rate slightly faster than that of the GDP. The multilateral real exchange rate remained stable during the year, at a level 23.4% higher than the one seen before the pervasive foreign exchange controls were removed. At the same time, credit continued to grow significantly. Total credit in real terms increased at a year-over-year rate of 24.6% in December, 2017, with a monthly expansion in mortgage loans, also in real terms, of 7.5% in the last two months of the year, with equals a cumulative growth of 70.9% in 2017.

Disinflation was not as fast as the BCRA intended. The first factor that explains the deviation relative to the target is a monetary policy which was relaxed between October, 2016, and March, 2017, as a response to the lower inflation level seen in the second half of 2016. This policy, ex post, was less contractive than required. The second factor was an increase in regulated prices which was higher than the increase estimated by the BCRA, with a direct impact of over 2 p.p. on annual inflation. Finally, while nominal medium-term contracts in 2017 took into account the expectations as regards future inflation, there was a certain persistence of past inflation, for instance, in labor contracts.

Chart 1.1 | Disinflation path
(Core inflation; m.o.m. % chg.)



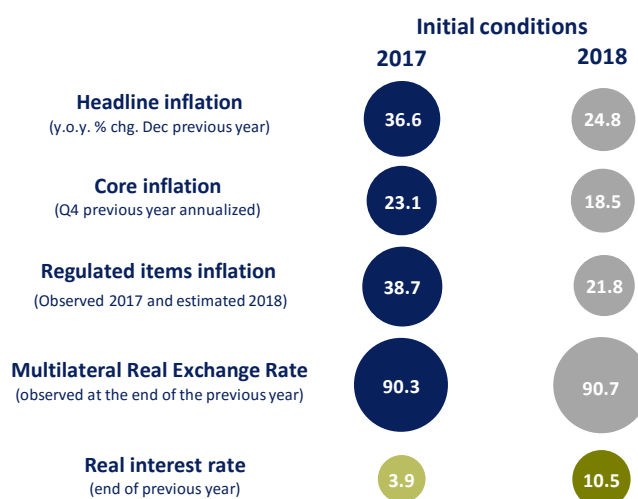
Source: BCRA from INDEC data

Monetary policy significantly increased its contractive bias starting in the second quarter, through increases in the policy rate and in the operations in the LEBAC secondary market. Thus, starting in May, 2017, the economy has resumed the path of decreasing core inflation stipulated in the January, 2017, Monetary Policy Report, breaking in the second half of the year the persistence it brought from 2016.

However, as the initial inflation level was higher than the one expected, due to the cumulative deviation of the first half of the year, the inflation rate ended up above the intermediate inflation target set for 2017. In these conditions, the postponement of the target of 5% to 2020 (rather than 2019), with intermediate inflation targets of 15% in 2018 and 10% in 2019, implies a path consistent with the disinflation rate recorded in the second half of 2017.

The continuation of the disinflation rate in 2018 benefits from initial conditions which are more favorable than those of 2017. The contractive bias of the monetary policy is higher, with a real interest rate which is well above that of early 2017. It is expected for regulated prices to increase 21.8% (compared to the increase of 38.7% for 2017). Moreover, the distance between the inflation rate (both headline and core) at the end of 2017 and the target is much lower than the one seen in late 2016, which reduces the challenge of inertial inflation.

Chart 1.2 | Initial conditions. 2017 vs. 2018



Source: BCRA

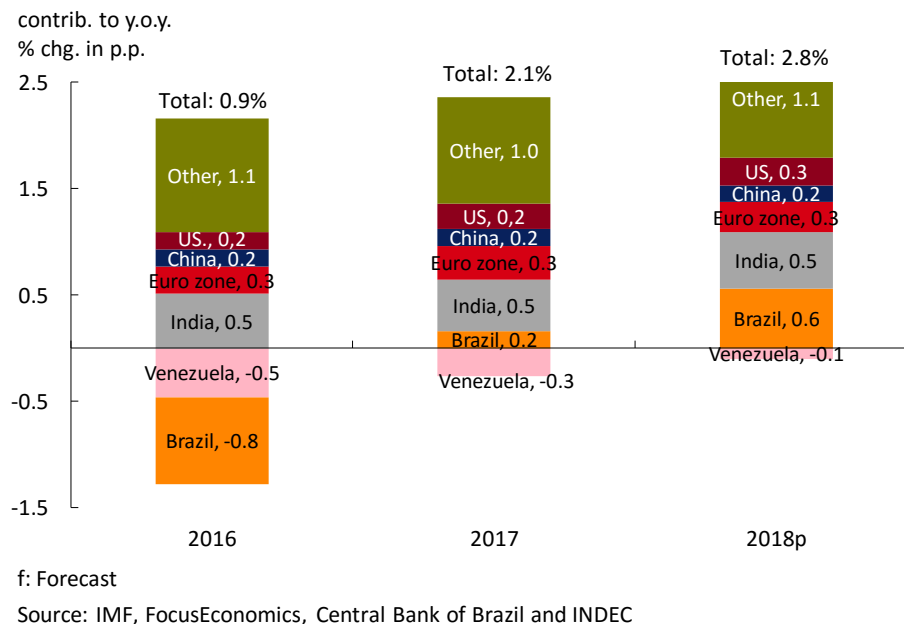
Considering the rate of disinflation and the set of initial conditions, the BCRA will cautiously adjust the contractive bias of its monetary policy in order to reach its intermediate targets of 15% inflation in 2018, 10% in 2019, and 5% in 2020. Thus, it will promote monetary stability, financial stability, employment, and economic development with social equity.

2. International Context

International context impacts Argentina mainly through three channels. First, global economic activity directly affects our foreign trade and foreign investment flows. Second, international credit markets condition influences the cost of sovereign indebtedness and private project funding. Last, the terms of trade impact our foreign trade, affecting wealth and incentives for production, consumption, and investment.

World economic activity continued to improve in the last few months, both in advanced and emerging countries, with a favorable performance in international financial markets. The projections for 2018 suggest that this behavior should continue (see Figure 2.1). In Argentina’s main trade partners, growth accelerated over 1 percentage point in 2017 relative to that of the previous year; and a 0.7 percentage points increase is projected for 2018, with a 2.8 percent growth. Moreover, credit conditions are still favorable for Argentina, both for the public sector and for firms, which is expected to last throughout the year. On the other hand, the prices of the country’s main raw materials for exportation have been relatively stable over the course of the year, while the real multilateral exchange rate depreciated 0.5 percent in 2017 (between the extremes).

Figure 2.1 | Argentina’s main trade partners growth



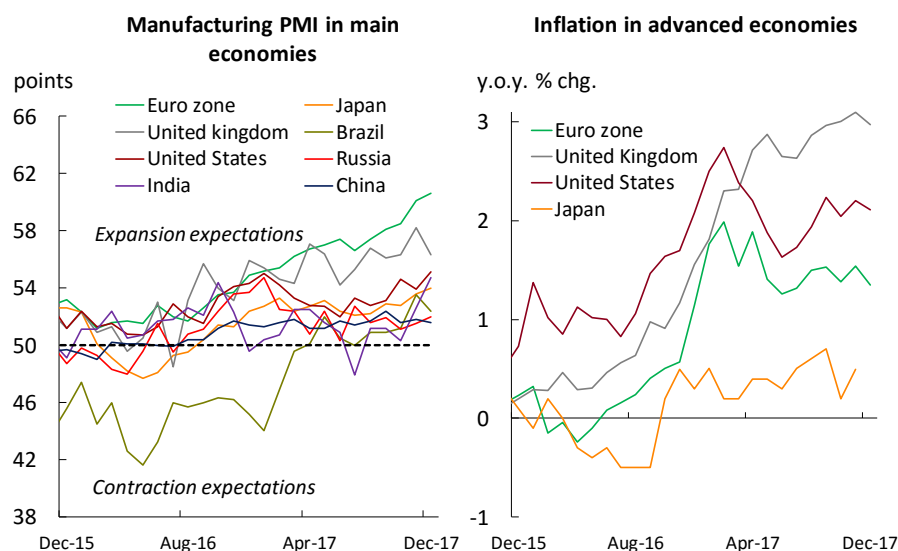
So far, the perspectives of a gradual increase in the US monetary policy rate have not affected this favorable scenario. Potential protectionist measures are a risk for the real international economy. Meanwhile, the largest source of potential volatility in the financial markets seems to lay in geopolitical tensions or in the uncertainty associated with elections in Europe and Latin America.

2.1 A higher level of economic activity is expected for 2018, both at the global level and for the majority of our trade partners

All leading activity indicators available for the major economies suggest an expansion, mostly with values above those observed in the previous IPOM. On the other hand, according to the most recent data, 2017

inflation should have ended below the highest levels reached over the course of the year, although with increases in the margin. Thus, US inflation is near the target, UK inflation is 1 percentage points above it, while inflation in the euro area and Japan is below the target (considerably so, in the case of Japan; see Figure 2.2).

Figure 2.2 | Leading indicators of manufacturing activity and inflation



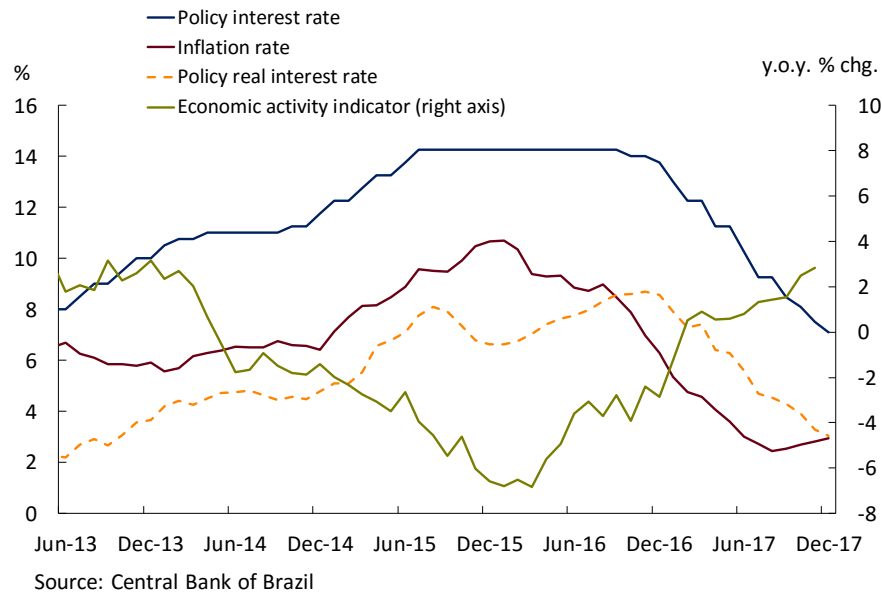
Inflation measured by Consumer price index.

Source: Datastream

Brazil, Argentina's main trade partner and a decisive player in the region's economic performance, continues to grow. GDP grew for the third consecutive quarter, with a 0.2 percent increase in July-September relative to the previous quarter (s.a.), a lower rate than in the two preceding quarters (0.7 percent and 1.3 percent). The Index of Economic Activity built by the Central Bank of Brazil (BCB) grew 0.5 percent in November relative to October (s.a.) and 2.8 percent year on year (see Figure 2.3). The Index of Industrial Production also increased 0.2 percent in November relative to October (s.a.) and 4.6 percent year on year. Finally, the latest projections of the Focus survey, carried out by the BCB among market analysts, foresee a 2.7 percent GDP increase in 2018, slightly above the 2.5 percent projected at the date of release of the previous IPOM. The realization of these forecasts would entail a favorable impact on bilateral trade, given that the higher growth of the Brazilian GDP expected for 2018 would contribute a 0.24 percentage points increase in the Argentine GDP in 2018 only through the trade channel.¹

¹ See [Brasil y su Efecto en la Actividad Argentina: una Mirada al Canal Comercial](#), in *Ideas de Peso*. As stated there, this estimation is among the most conservative ones, while others foresee a higher impact.

Figure 2.3 | Brasil. Macroeconomic indicators



In a context of disinflation, the BCB continued to lower its monetary policy rate (the goal for the Selic rate). This decision is based on the fact that inflation ended 2017 at 2.95 percent, below the 4.5 ± 1.5 percent target. The Selic rate is at 7 percent, 125 basis points below its October 2017 level. This resulted in a fall of the monetary policy rate in real terms. According to the Focus survey, the target for the Selic rate is expected to remain virtually unchanged over the course of 2018.

The euro area, the second destination of Argentine exports, continues to consolidate its economic recovery, based on growth data for the third quarter, leading indicators (see Figure 2.2) and projections for 2018. Seasonally adjusted GDP grew 0.6 percent in the third quarter relative to the second, and 2.6 percent year on year. The latest projections from the European Central Bank (ECB) foresee a 2.3 percent and 1.9 percent growth for 2018 and 2019, respectively (0.5 percentage points and 0.2 percentage points more than the previous projection, respectively).

With the November inflation below the 1.5 percent target, the ECB kept its monetary interest rate unchanged at the historical low of zero percent. The ECB projects a 1.4 percent inflation rate for 2018, slightly below the projection for 2017 (1.5 percent). Nevertheless, at its October monetary policy meeting, the ECB lowered the amount of its asset purchase program and extended its execution to September 2018. In this way, from January 2018 onward, the Central Bank is set to acquire financial assets by 30 billion euros per month (half the amount it had been purchasing until then).

In the US, the third destination of Argentine exports, the economy grew 3.2 percent (year on year) in the third quarter, surpassing market projections. The unemployment rate (4.1 percent in December) is at its lowest since late 2000, and below non-accelerating inflation rate of unemployment levels (NAIRU), despite the fact that job creation slowed in the last few months, since the labor participation rate also did it. As regards growth projections, the Federal Reserve increased its estimations both for 2018 and 2019, to 2.5 percent² and 2.1 percent, respectively (0.4 percentage points and 0.1 percentage points above the working projections at the release of the previous IPOM).

At its December meeting, the Fed’s Monetary Policy Committee announced a new increase in the reference interest rate to the 1.25-1.5 percent range, as expected. Besides, the Fed itself foresees new increases of at

² US growth in 2018 might be fueled by the fiscal stimulus resulting from the recently passed [tax reform](#).

least 0.75 percentage points over the course of 2018. Lastly, the Fed's balance normalization program³ has been in effect since October, which, in practice, entails a less expansionary bias in the monetary policy, given that liquidity is absorbed in the market through the sale of securities owned by the Central Bank.

China, the main destination of Argentine basic commodity exports, is expected to have ended 2017 with a 6.8 percent year-on-year GDP growth, mainly due to private consumption and investment. It should be noted that imports have continued to be dynamic throughout the last few months, which had grown at 18.7 percent year on year in October, partially because of the 6.3 percent yuan appreciation relative to the US dollar in 2017. Lastly, a lesser growth of the GDP is expected for 2018, at around 6.6 percent, mainly due to the reduction in exports growth.

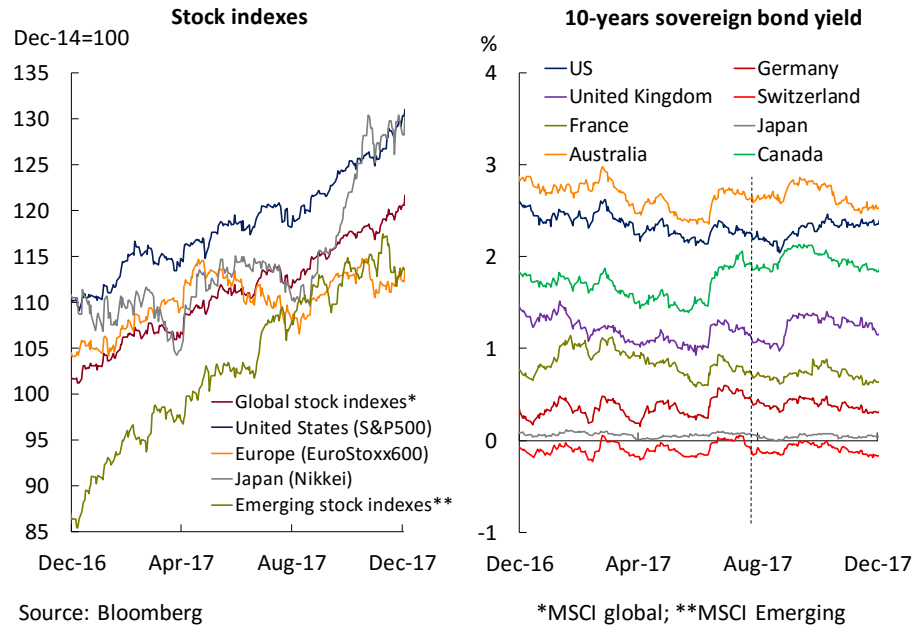
2.2 Favorable Credit Conditions for Argentina Expected to Continue in 2018

Since the release of the previous IPOM, three central banks that have carried out a markedly expansive monetary policy in the last few years have adopted measures to reduce that stimulus. The Fed and the ECB have started to cut the non-conventional monetary stimulus, although the former has gone farther in the process. The Bank of England has also taken contractive monetary policy measures for the first time in over ten years. The Bank of Japan continues to carry out its quantitative expansion program, although it might start cutting it in 2018. Despite the recent steps taken by the Fed, the ECB and the BoE, the great monetary expansion of the last decade makes it possible to expect that global liquidity conditions remain abundant for emerging countries, which would allow Argentina to continue to be financed in favorable conditions.

In general, international financial markets have maintained their upside bias and lesser volatility both for variable and fixed income assets (see Figure 2.4). Stock indices have kept their upward trend throughout 2017, reaching in some cases historical peaks, such as the S&P500, or records in the last 25 years, such as the Nikkei. The yields of public debt securities in most developed countries showed a downward trend during 2017, which started reversing in September, after the Fed's announcement of the launch of its balance normalization program. However, the securities ended 2017 with a lower yield than a year before (December 2017 average relative to December 2016 average).

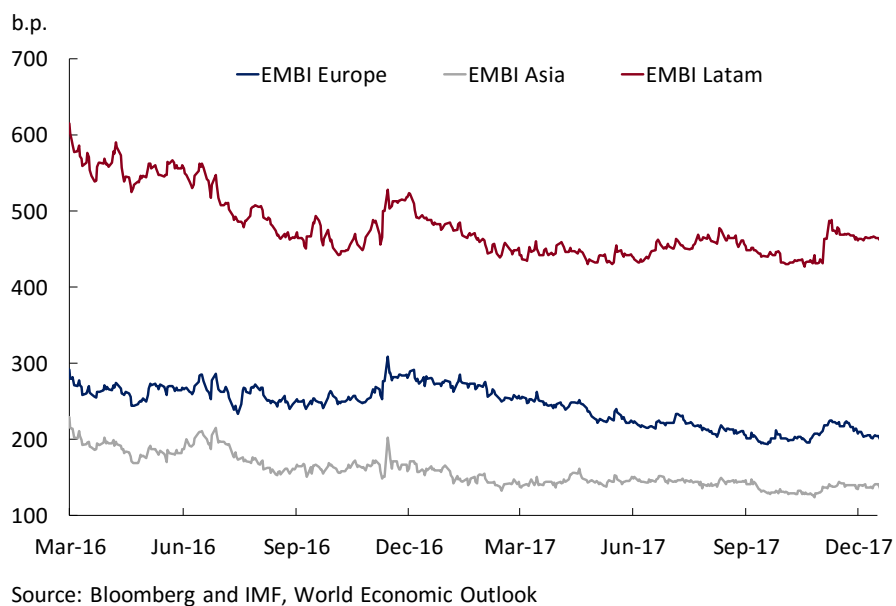
³ For more detail, see the corresponding [document published on the Fed's website](#).

Figure 2.4 | Stock indices and 10-Year sovereign bond yields



Over the course of the year, the sovereign risk premiums of emerging countries were also reduced. Still, they tended to increase after the Fed’s September announcement, particularly in the case of Latin America (see Figure 2.5.)

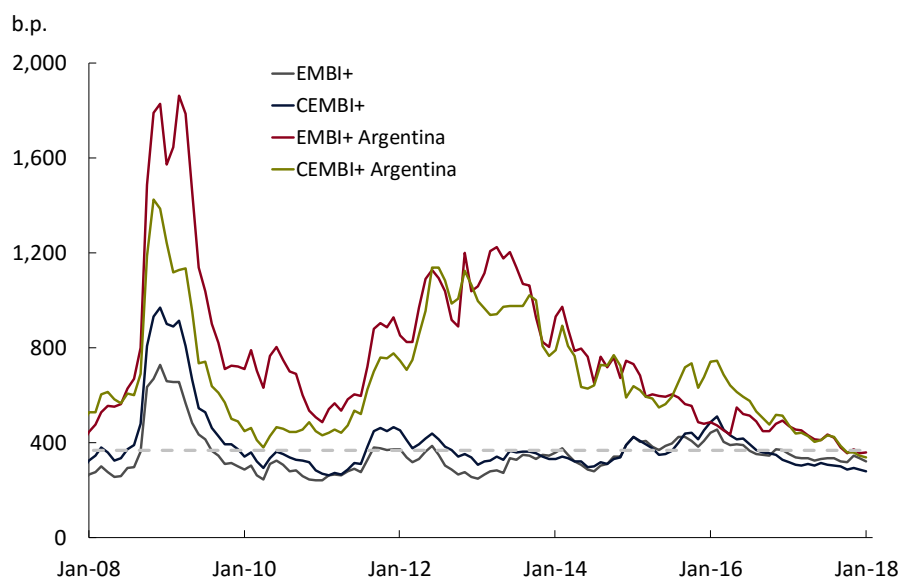
Figure 2.5 | Emerging countries. Sovereign risk premiums



In gross terms, the total amount of emerging countries debt issuance in international markets (sovereign and corporate debt) increased 38 percent year on year in 2017, with a rise in the corporate sector share. In Argentina, the gross amount of placements in international markets rose 7 percent: 6 percent in the non-financial public sector (NFPS, excluding from the calculation 2016 issuance linked to the restructuring of defaulted debt) and 11 percent in the corporate sector. In early 2018, the NFPS placed around 9 billion US dollars in debt.

For Argentina, credit conditions improved even more than for the rest of the emerging countries, since the Argentine country risk was set around 360 b.p. for the EMBI+ Argentina index (almost unchanged relative to the previous IPOM), and 356 b.p. for the CEMBI+ Argentina, slightly below October, both values being the lowest in the last ten years (see Figure 2.6). Thus, the Argentine public sector and firms are being funded at lower interest rates in the international markets.

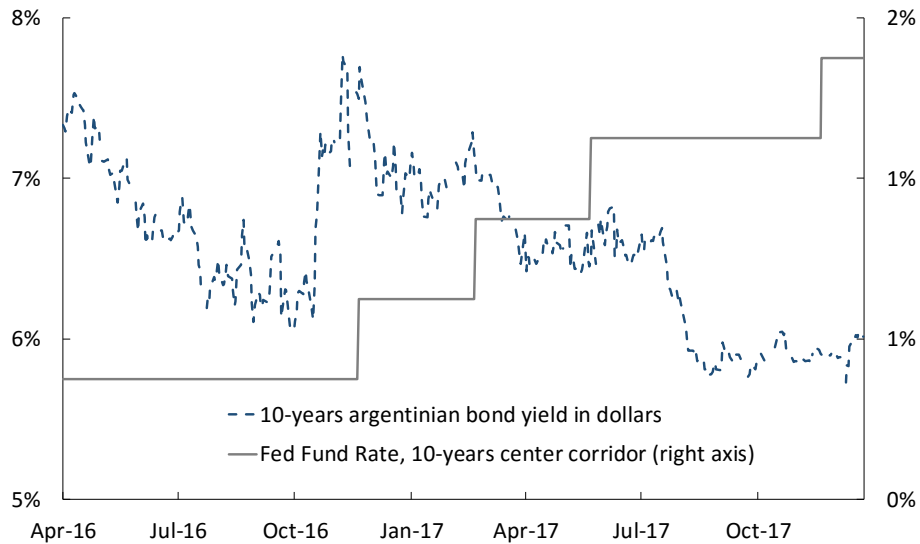
Figure 2.6 | Risk indicators for sovereign and corporate debt



Source: Bloomberg

It should be noted here that the increases in the Federal Funds rate expected for 2018 would have a negative effect in the external funding conditions for Argentina. However, this effect can be offset if Argentine securities' risk premiums continue to fall, as they have done since 2016 (see Figure 2.7). In fact, a comparison of the EMBI index for Argentina with those for countries like Brazil, Colombia or Mexico, for instance, shows that the cost of external funding can still be significantly reduced.

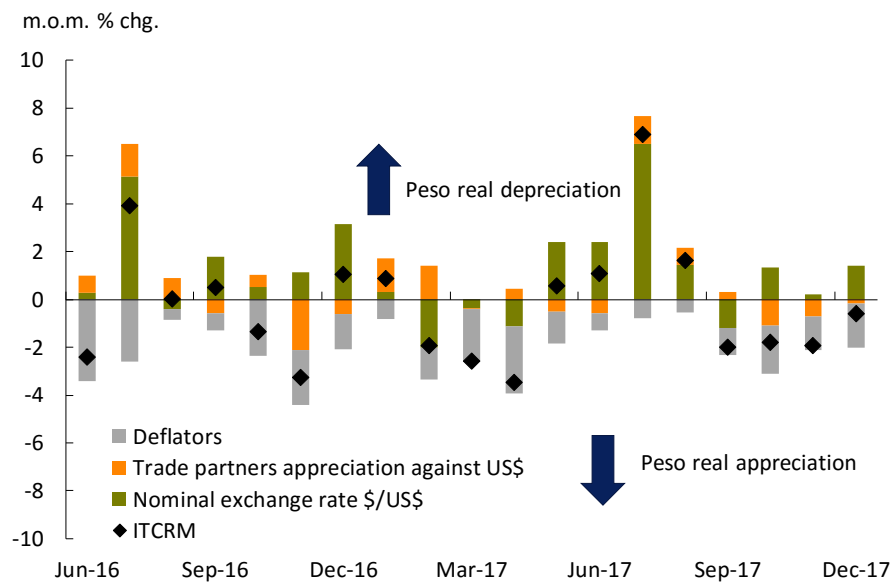
Figure 2.7 | Cost of external indebtedness and monetary policy interest rate of the Federal Reserve



Source: BCRA and Federal Reserve Bank of Saint Louis

The Multilateral Real Exchange Rate Index (ITCRM) appreciated 4.1 percent during this quarter, both due to the 1.0 percent depreciation of the currencies of our trade partners relative to the US dollar and the higher relative inflation in Argentina. However, this was partly offset by the nominal depreciation of the Argentine peso relative to the US dollar (1.6 percent; see Figure 2.8).

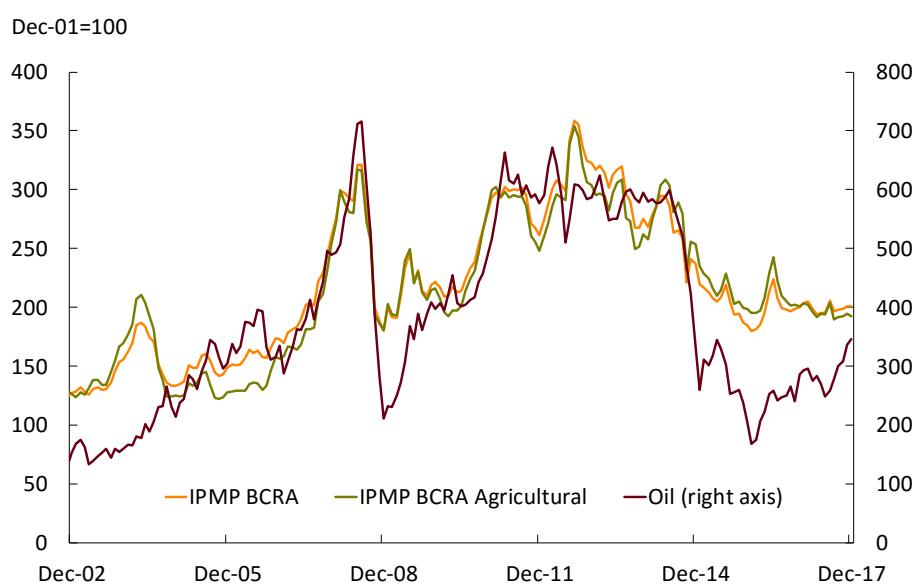
Figure 2.8 | ITCRM change by component



Source: BCRA

Commodity prices continue to evolve differently for oil and for non-oil materials. Oil prices, which initiated an upward trend in mid-2017, have continued to rise, with a 44 percent accumulated increase. On the other hand, the commodity price index (IPMP BCRA) —which reflects the evolution of the main exported commodities in Argentina, with a marked influence on the local economic cycle— has been relatively stable in the last few months (0.3 percent year on year change in December.) The agricultural IPMP BCRA has moderated its downward trend of the last few months (-21 percent in December relative to June 2016, see Figure 2.9), partially due to an increase in the price of soy in the last months of the year.

Figure 2.9 | International commodity prices

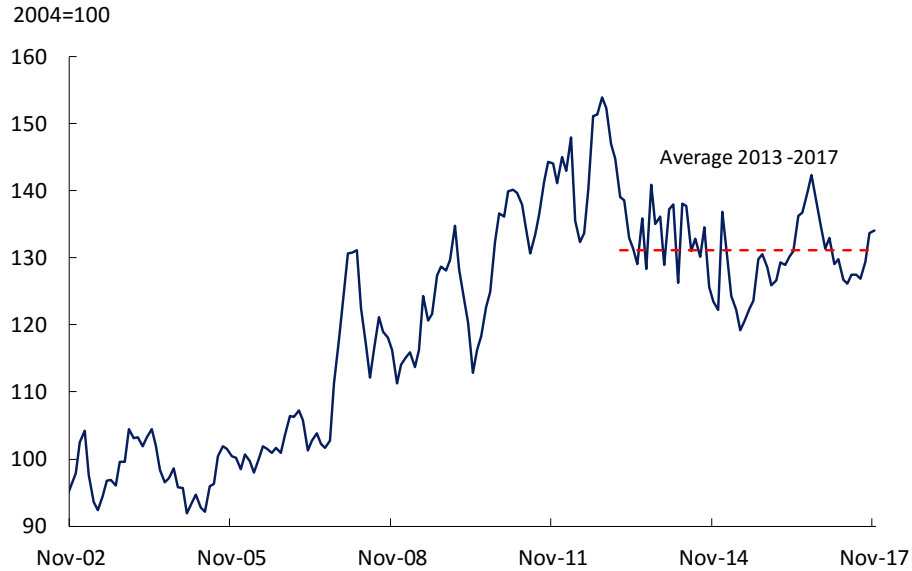


Source: BCRA

Finally, the terms of trade (the ratio between Argentine export and import prices)⁴ have remained below the 2013-2017 average during most of 2017. In the last quarter of the year, they seemed to be recovering (with data up to November; see Figure 2.10).

⁴ A fall in the terms of trade negatively impacts the Argentine trade balance, while a rise has a favorable impact.

Figure 2.10 | Terms of trade index



Source: INDEC

In sum, the expectation for the next few months is for global economic activity to improve, particularly in the case of our trade partners. This should have a positive impact on the demand for Argentine exports. Moreover, the ample liquidity conditions for emerging countries should continue in 2018, despite the tightening of the monetary policy in the central banks of certain advanced countries. Therefore, credit conditions for Argentina can be expected to continue to be favorable.

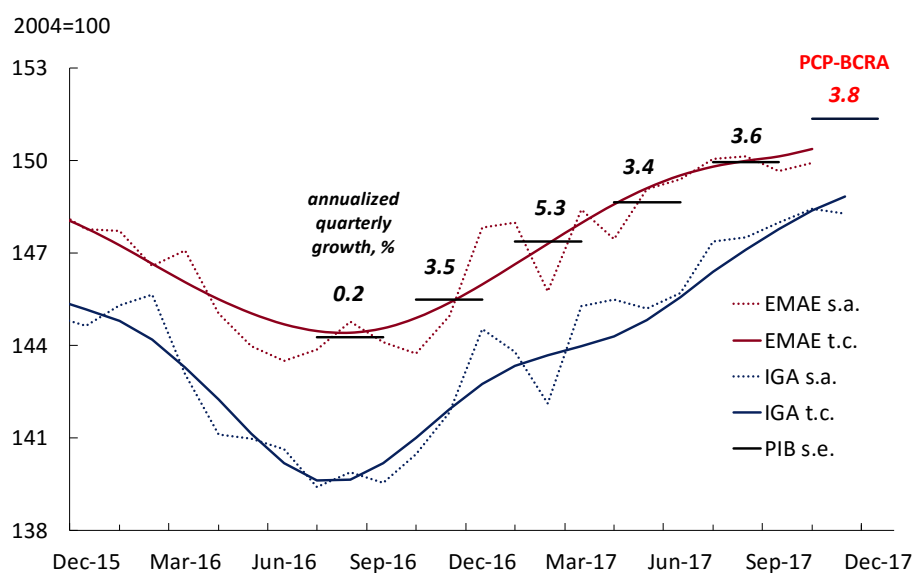
3. Economic Activity

The economy reached a year of uninterrupted economic growth: the longest expansion phase since 2009–2011. The policies aimed at correcting macroeconomic imbalances and structural reforms have made it possible to grow during 2017 at a sustained annualized 4 percent rate, with low volatility. Investment continues to show a significant role, private consumption is slightly above its trend, and government consumption is slowing down. At the sectoral level, the expansion is widespread and coupled by productivity gains in most sectors. At the same time, the real exchange rate has remained stable under floating regime, and real wages have grown. The BCRA expects for this sustained growth with low volatility to continue, leaving behind the output stagnation stage. This view is shared by the participants of the Market Expectations Survey (REM), who projected for the economy to continue to expand at a rate of approximately 3 percent in 2018 and 2019.

3.1 The economy Reached a Year and a Half of Uninterrupted Growth

During the fourth quarter of 2017, the economy completed six quarters of uninterrupted growth with a fall in volatility. The last GDP Contemporary Forecast of the BCRA (PCP-BCRA) suggests a quarterly, seasonally-adjusted increase of 0.94 percent, while the REM analysts forecast points at a seasonally-adjusted 1 percent increase⁵. Thus, the GDP would have expanded at an annualized quarterly average rate of approximately 4 percent in 2017 (see Figure 3.1).

Figure 3.1 | Economic activity

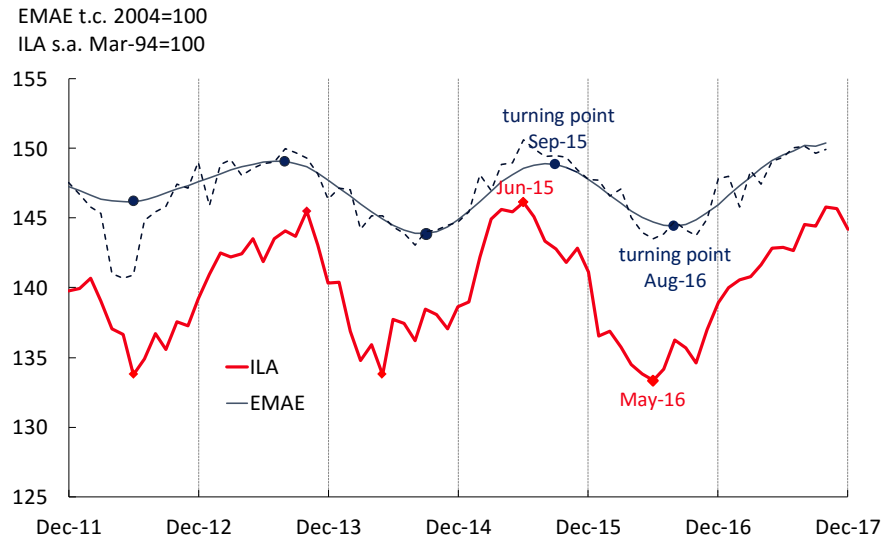


Source: INDEC, BCRA and Orlando J. Ferreres (OJF)

⁵ November, 2017, REM.

While the leading indicator of economic activity (ILA) prepared by the BCRA showed a decrease in December, this indicator continues to anticipate that the expansionary cycle will continue in the next few months⁶ (see Figure 3.2).

Figure 3.2 | Leading indicator of economic activity



Nota: t.c.: Trend-cycle. Source: INDEC, Sectoral associations, Bloomberg and UTDT

3.1.1 Domestic Demand Expands Faster than the GDP, at Annual Rates of over 5 Percent

In the third quarter, domestic demand —total consumption and investment— grew at a year-over-year rate of 5.7 percent, led by investment (13.9 percent year-over-year), with a high share of the imported component (see Table 3.1).

Table 3.1 | GDP growth and contributions of its components

	Q4-16	Q1-17	Q2-17	Q3-17	Q4-16	Q1-17	Q2-17	Q3-17	y.o.y. chg. Q3-17	
	q.o.q. % chg. s.a.				contribution to GDP q.o.q. % chg. s.a. in p.p.*				%	contribution to GDP y.o.y. chg. in p.p.*
GDP constant prices	0.9	1.3	0.8	0.9	0.9	1.3	0.8	0.9	4.2	4.2
Domestic expenditure	-0.3	2.4	3.9	-1.0	-0.3	2.5	4.1	-1.1	5.7	6.1
Private consumption	-0.5	1.9	4.0	-2.2	-0.4	1.4	2.9	-1.7	4.2	3.1
Public Consumption	-2.6	2.4	1.1	0.5	-0.4	0.3	0.1	0.1	1.8	0.3
Gross fixed investment	2.3	4.0	5.1	2.5	0.4	0.8	1.0	0.5	13.9	2.8
Net exports					-0.4	-0.5	-2.7	-0.9		-4.8
Exports	3.4	3.0	-6.2	2.4	0.7	0.6	-1.3	0.5	2.1	0.5
Imports	3.9	4.0	5.1	4.6	-1.0	-1.1	-1.4	-1.3	18.7	-5.2
Statistical discrepancy and change in inventories					1.5	-0.7	-0.5	2.8		2.9

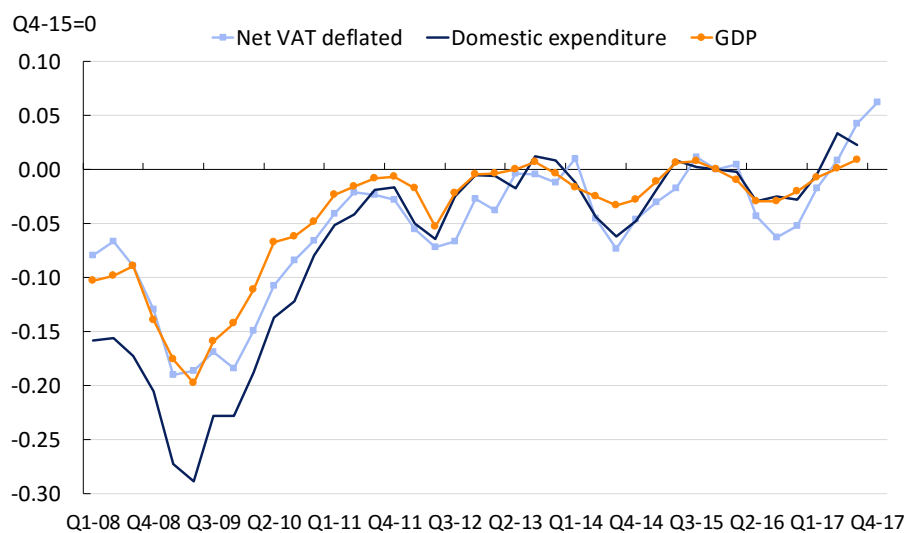
*Contribution of components to GDP annualized growth. It is calculated as the percentage variation of each component multiplied by its correspondent weight in previous period GDP.

Source: INDEC

⁶ This reduction in the December ILA is not enough to signal a change in the phase of economic cycle, seeing as it is only one of the necessary signals to issue a turning point alert. It should be noticed that in other months coinciding with expansionary periods, such as September/October, 2016, there were similar falls in the ILA, without a change in phase in the economic cycle. For greater detail, see Exhibit 3/ BCRA Leading Activity Index, January 2017 Monetary Policy Report.

Different partial measures suggest that domestic demand continued to increase in the last quarter of last year. The gross VAT income deflated by the national CPI (net of reimbursement to grain producers) increased at a quarterly, seasonally-adjusted rate of 2.0 percent (see Figure 3.3). Imported volumes associated directly to consumption and investment increase at a seasonally-adjusted 1.1 percent in the October-November period, relative to the previous quarter. Together, individual and credit card loans grew at a quarterly, seasonally-adjusted rate of 2.2 percent in real terms.

Figure 3.3 | Collection of VAT, Domestic Expenditure and GDP

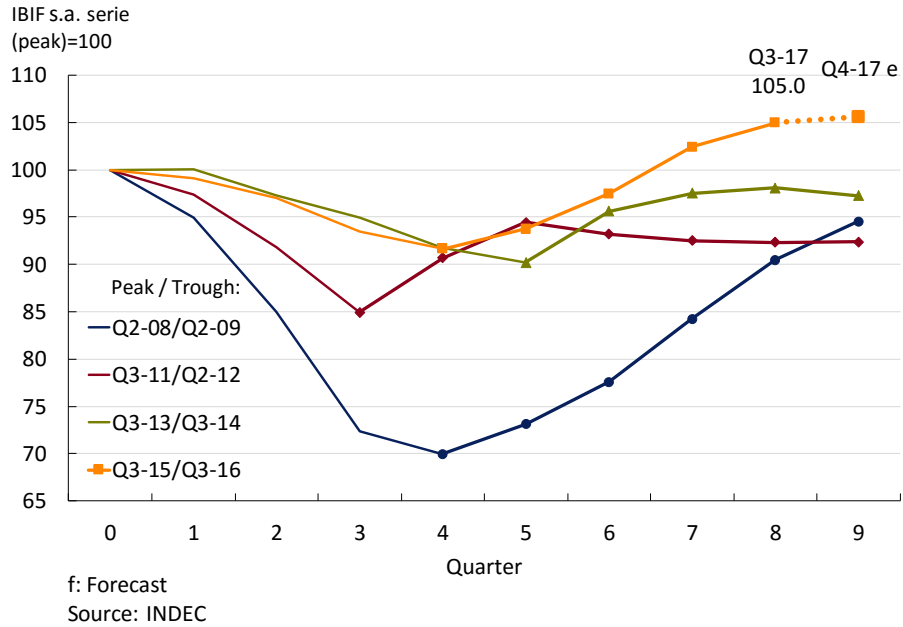


Source: INDEC, Ministry of Treasury and Statistical Offices of the City of Buenos Aires and San Luis.

3.1.2 Investment Consolidates its Central Role in Growth

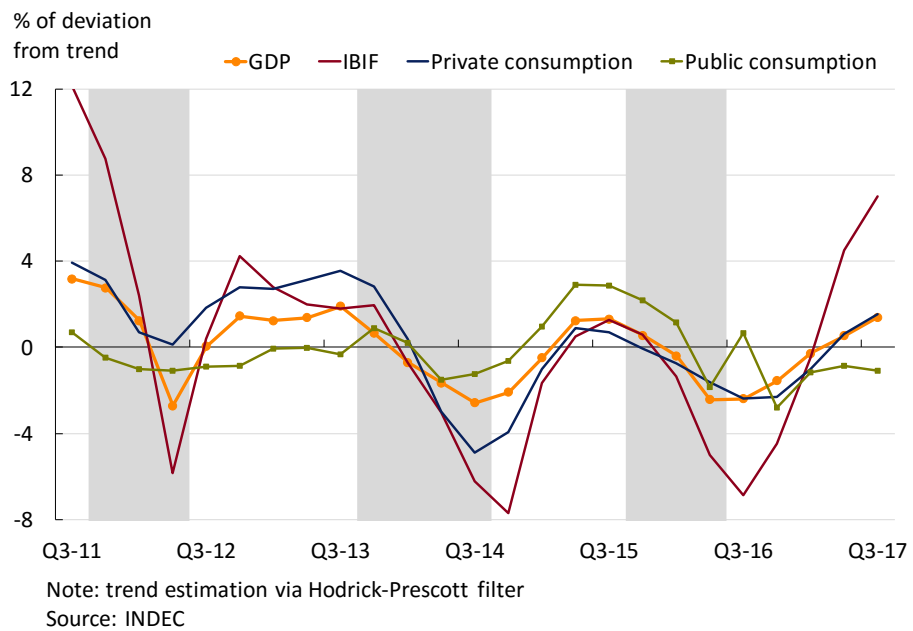
In line with what was anticipated in the last Monetary Policy Report, gross domestic fixed investment grew for the fourth time in a row in the third quarter of 2017, at an average annualized rate of 14.6 percent. Leading indicators —volume of sales of national and imported production equipment and the evolution of construction— make it possible to anticipate a new increase in the fourth quarter of the year, which would mean that investment remains clearly above the levels seen in other economic recoveries in recent history (see Figure 3.4).

Figure 3.4 | Gross fixed investment evolution during last expansions



Investment is now the component of aggregate expenditure exerting the greatest traction on the output cycle, unlike previous cyclical recoveries, which were mainly driven by government or private consumption (see Figure 3.5).

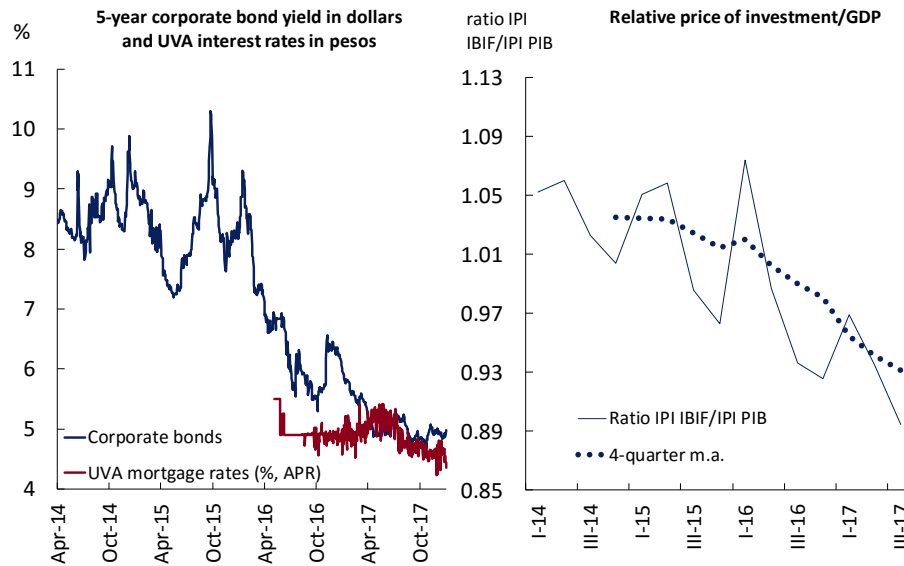
Figure 3.5 | Cycles of GDP, investment and consumption



Starting in 2016, gross domestic fixed investment responded positively to the elimination of distortions and the correction of macroeconomic imbalances. The decrease in investment costs, together with expectations as regards productivity growth, drove the expansionary cycle of investment forward (see Figure 3.6). The

former is related to the decrease in the relative price of capital and to the fall in interest rates faced the public and private sectors in international markets. Thus, investment left behind four years of stagnation.

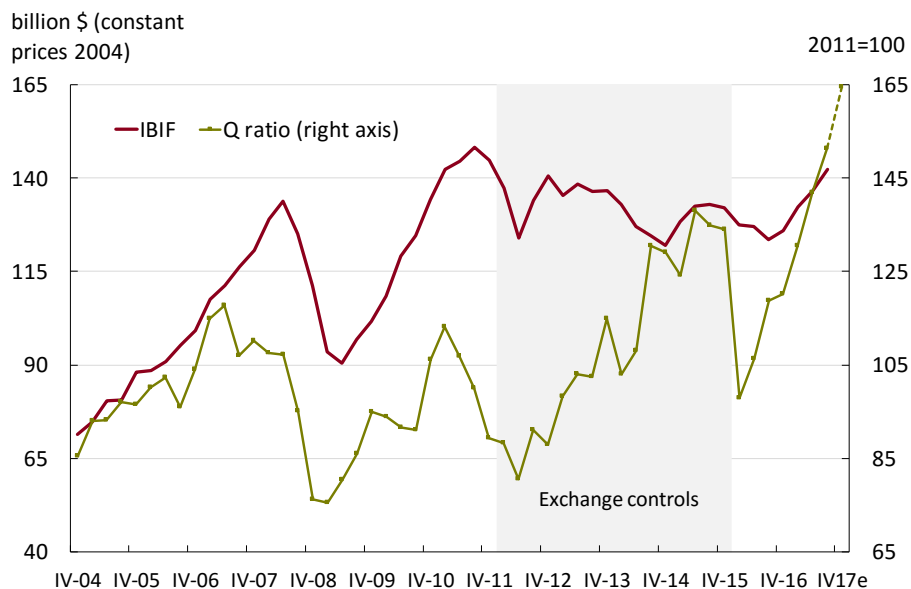
Figure 3.6 | Yield, interest rates and relative price of investment



Source: INDEC and BCRA

This improvement in investment can be anticipated by the Tobin’s Q ratio, which relates the market value of invested assets with their replacement cost. During 2004–2017, it is possible to see that, when the Q ratio increases, investment responds positively, and vice-versa, with the exception of the 2013–2015 period, which is atypical, as there was an increase in the market value of assets relative to their replacement cost, without a corresponding increase in investment. This could be interpreted as evidence of the impact of exchange rate restrictions and the expectation for economic recoveries aimed at improving the business climate. This optimism in the markets was not translated into an increase in investment until after the macroeconomic reconfiguration. The strong increase posted by the Q ratio seen in 2017 makes it possible to foresee that investment will continue to show a positive dynamics in the next few months (see Figure 3.7).

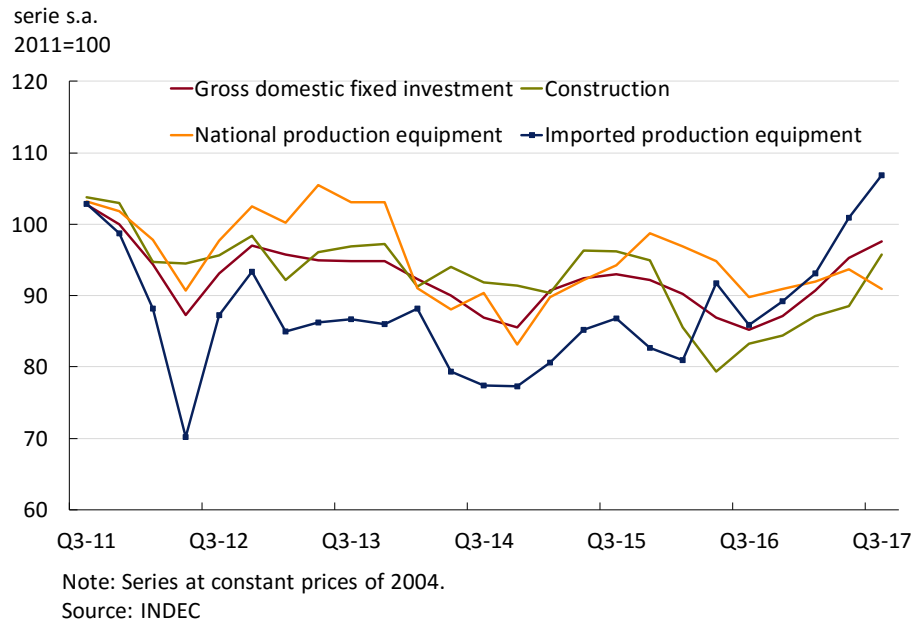
Figure 3.7 | Investment and ratio between market value and cost of assets



Source: INDEC, UADE, Statistical Office of the City of Buenos Aires and Merval

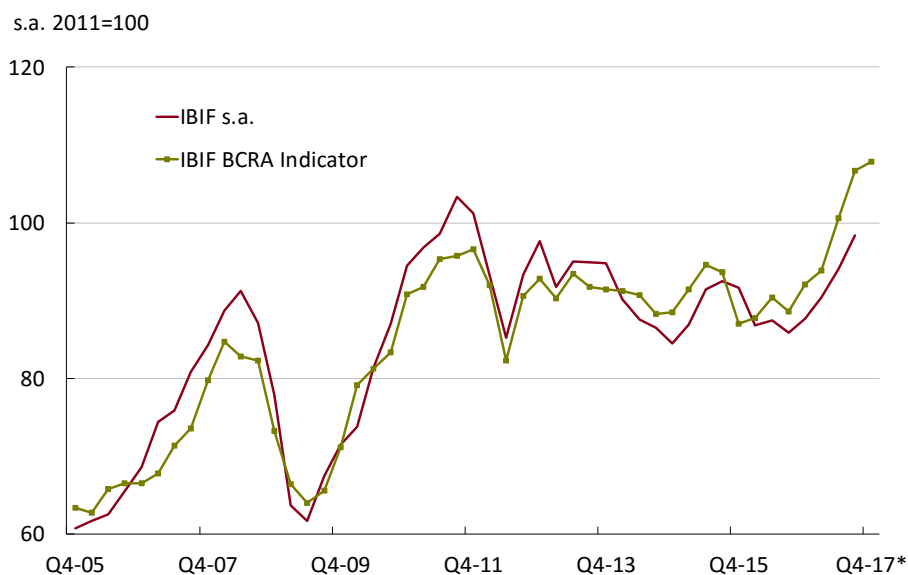
The growth of investment seen in the third quarter of 2017 responded to the combined increase in construction (14.7 percent year-over-year in the third quarter) and durable equipment (15 percent year-over-year)⁷, with a strong share of expenditure in imported machinery and equipment (30.3 percent year-over-year), which, measured at 2004 prices, reached a record 35.4 percent in gross domestic fixed investment (see Figure 3.8).

Figure 3.8 | Investment components



In the last quarter of 2017, leading indicators suggest that investment will have remained in an upwards trajectory. The BCRA indicator of gross domestic fixed investment⁸ (IBIF BCRA), which is a weighted average of variations in leading indicators, increased a quarterly, seasonally-adjusted 1.1 percent (17.1 percent year-over-year). In this line, the Contemporary Investment Index prepared by the Finance Ministry posted a year-over-year increase of 16.4 percent. Thus, the growth of investment in 2017 would have been the highest in the last six years (see Figure 3.9).

⁷ Other constructions and other fixed assets grew 0.8 percent year-over-year and 3.7 percent year-over-year, respectively.
⁸ Quarterly changes in the IBIF-BCRA are a weighted average of seasonally-adjusted quarterly changes in the ISAC (INDEC), in capital goods imports (INDEC) and in the national production of capital goods (FIEL). The weights correspond to the weight of construction, investment in imported durable production equipment (EDP) and national EDP in the last quarter's gross domestic fixed investment. This indicator does not consider the categories "Other constructions" and "Other fixed assets", which are part of gross domestic fixed investment, as there are no leading indicators for them. As of November, the ISAC grew at a seasonally-adjusted quarterly rate of 3.7 percent, imports of capital goods fell a seasonally-adjusted 1.3 percent, and domestic production of capital goods increased at a seasonally-adjusted rate of 0.6 percent.

Figure 3.9 | Gross fixed investment

Source: INDEC and FIEL

Box. Foreign Investment in Argentina

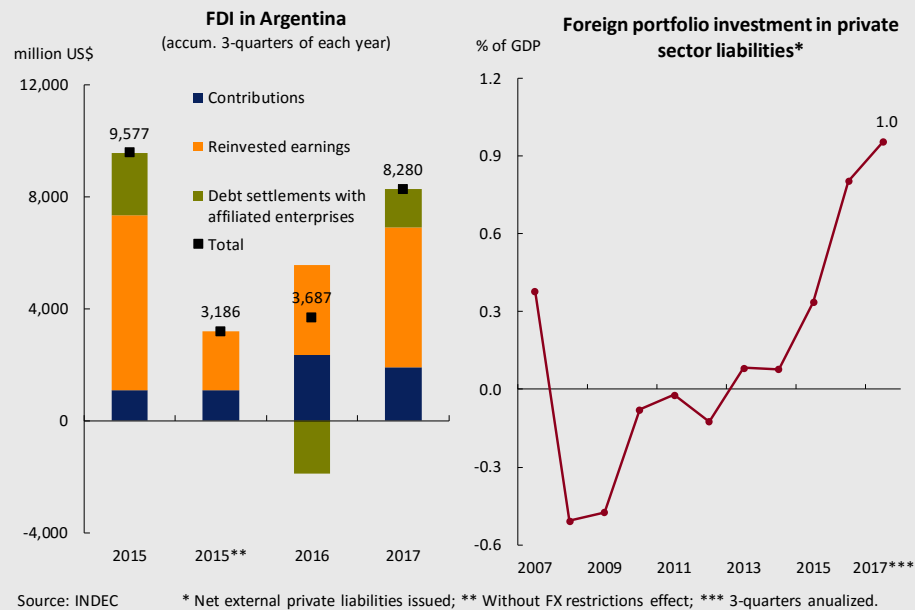
Foreign direct investment (FDI) inflows to Argentina amounted to approximately USD 8.3 billion in the first three quarters of 2017; USD 4.593 billion above the level seen in the same period in 2016. However, over 2016, companies normalized their relation with their HQ, which implied a reduction in the stock of commercial debt, as well as a greater remittance of profits retained during 2012–2015 (see Figure 3.10).

The 2017 level of FDI is lower than the one recorded in 2015 because, back then, companies' investment decisions were conditioned by the existence of exchange rate restrictions. If firms had been able in 2015 to remit to headquarters a share of the profits accrued similar to the one they submitted in 2004/2011, and if they had not been forced to increase their commercial debt, the flow of FDI in 2015 would have been closer to USD3.2 billion, substantially less than the level recorded in 2017.

Since the removal of exchange rate restrictions, capital contributions remained in levels higher than those of the previous period: from approximately USD 1,1 billion in the first three quarters of 2015, to USD 2.3 billion and USD 2.0 billion in the same period of 2016 and 2017, respectively.

The new rules in force since December, 2015, which made it possible for firms to access international credit markets once again, also had an impact on the portfolio investment flows in the private sector (issuance net of external liabilities through capital participation and debt securities). In the last 2 years, there was a greater inflow of external investment through that channel than in the last 10 years taken together.

Figure 3.10 | Foreign investments in Argentina



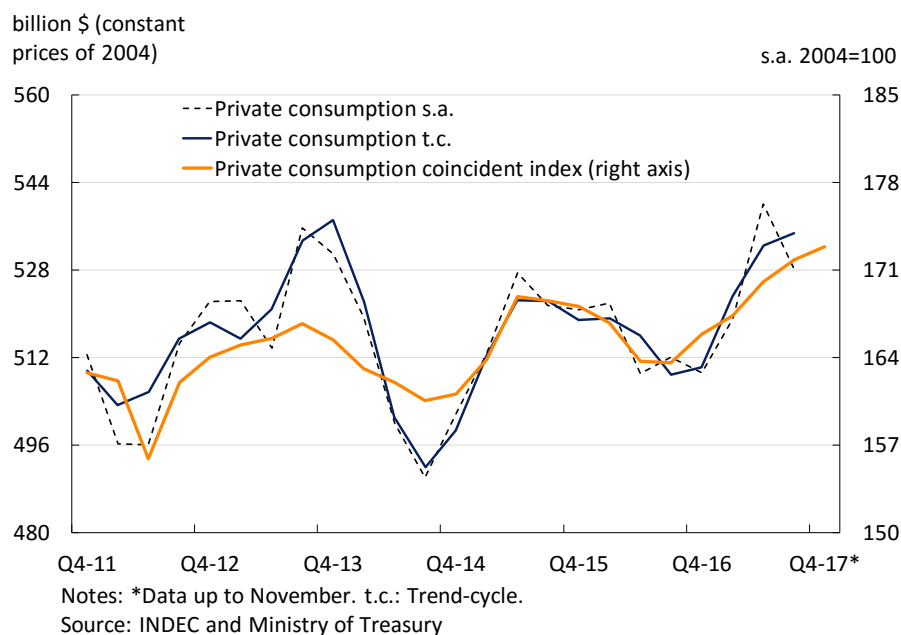
3.1.3 Private Consumption Remains in a Positive Trend

Private consumption increased at year-over-year rate of 4.2 percent in the third quarter of 2017, and fell 2.2 percent relative to the previous quarters in seasonally-adjusted terms, after an extraordinary increase of 4 percent in the second quarter. Given the high volatility shown by the series, which began in 2004, it is necessary to analyze the trend-cycle of consumption, which continued to grow in the third quarter (+0.4 percent, seasonally-adjusted)⁹.

Alternative indicators of private consumption show that it grew without interruptions since the third quarter of 2016, in line with the trend-cycle of the official series. The BCRA’s leading indicator of private consumption—a monthly index which includes traditional indicators of goods and services consumption, imports, consumers’ expectations, and indirect ways of computing structural changes in consumption¹⁰—revealed a turning point in October, 2016, which launched an expansionary phase. The contemporary consumption index of the Finance Ministry grew at a seasonally-adjusted rate of 0.6 percent in the fourth quarter, after posting a seasonally-adjusted growth of 1 percent in the previous one (see Figure 3.11).

⁹ The estimation of the trend-cycle of a series is very sensitive to the last data used, so it can be inferred that the growth in the trend of private consumption for the third quarter of 2017 would have been higher, if the improvement of the original series in the fourth quarter was confirmed.

¹⁰ For greater detail, see Exhibit 1/ Private consumption, a difficult variable to monitor in real time, July, 2017 Monetary Policy Report.

Figure 3.11 | Private consumption

3.1.4 The Negative Current Account Balance Mirrors the Expansion in Domestic Demand

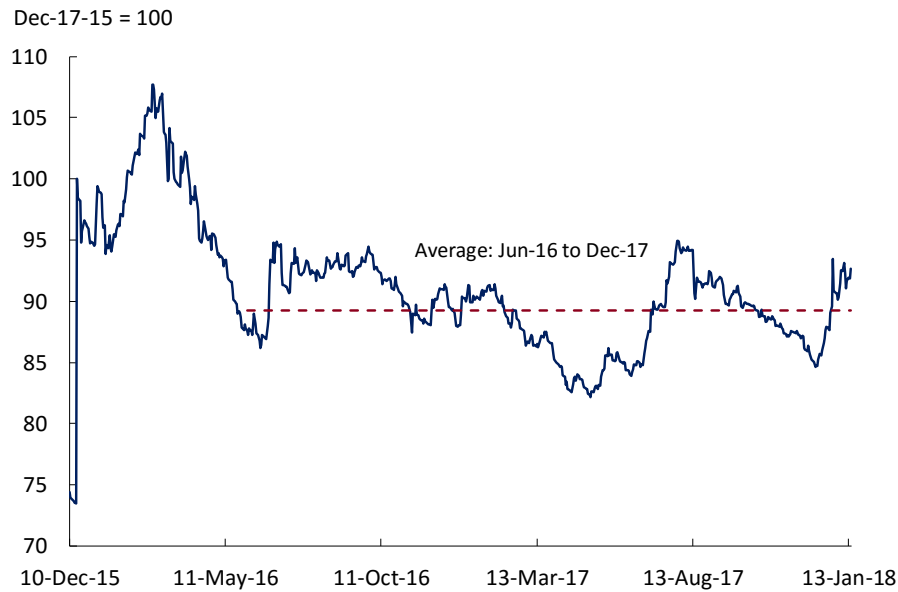
The increase seen in the current account deficit in 2017 reflected the greater dynamism of domestic demand relative to the product. This evolution in external accounts is to be expected, after the macroeconomic reconfiguration launched in late 2015 and the new growth prospects. These, coupled by the reduction in the cost of capital, have stimulated investment. Inasmuch as agents perceive an improvement in their permanent income and have access to credit, an increase in consumption is to be expected. Thus, the greater dynamism of investment relative to consumption leads to an increase in the current account deficit.

The greater level of access to external saving takes place from a position of stocks which is very favorable to Argentina, both at an aggregate and at a sectoral level. Argentina has an international investment position of approximately 5 percent of GDP, which turns it into a net creditor to the rest of the world. The levels of debt in households and companies are very low, while the public debt-GDP ratio is below the average for countries in the region¹¹.

It should be pointed out that the increase in the current account deficit happens in a context of relative stability of the multilateral real exchange rate (see Figure 3.12). Indeed, as of December 31, 2017, the Multilateral real exchange rate index (ITCRM) was 0.5 percent above the level seen exactly one year before, and 1.6 percent above the average recorded since June, 2016 (see Figure 3.12). In multilateral terms, the peso ended the year a 23.4 percent more competitive than before the December, 2015 exchange unification, due to a more marked depreciation relative to the Brazilian real (41.8 percent) than relative to the US dollar (13.6 percent).

¹¹ For more details, see the [Financial Stability Report of the second half of 2017](#).

Figure 3.12 | Real Effective Exchange Rate

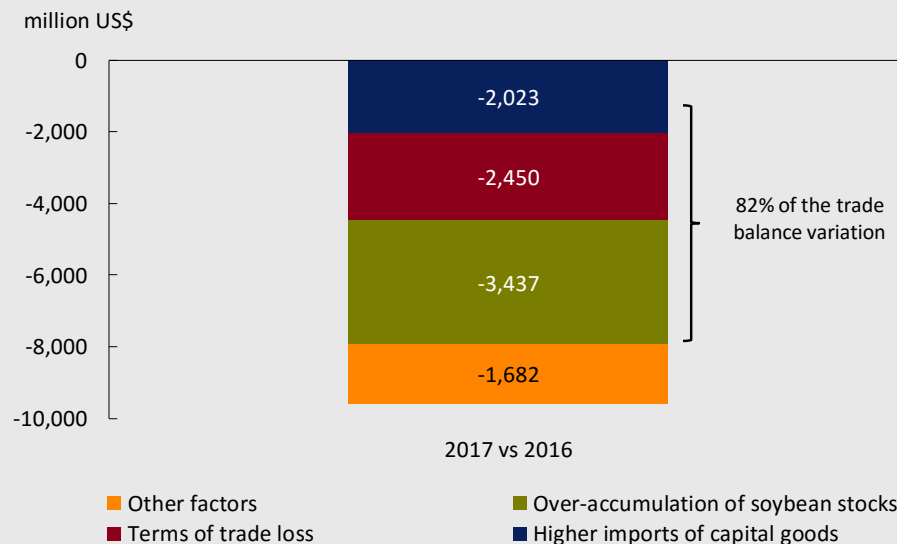


The higher current account deficit recorded in 2017 was largely accounted for by the strong dynamism of good imports, in a context in which exports remained virtually flat. With data as of November, 2017, exported volumes increased 1.2 percent year-over-year (with an increase of 1.1 percent in prices and stagnation in volumes), well below the year-over-year increase of 19.9 percent in imports, driven by an increase in volumes —13.2 percent year-over-year— and prices —6.0 percent year-over-year. The trade balance reverted, moving from a surplus of USD 1.935 billion between January and November of 2016, to a deficit of USD 7.656 billion, a year after.

Box. Drivers of the Increase in the Trade Deficit

Over two-thirds of the decrease in the 2017 trade balance were accounted for by the dynamic nature of external purchases associated with the investment process, after years of stagnation, the deterioration of the terms-of-trade, and the temporary accumulation of soybean stocks.

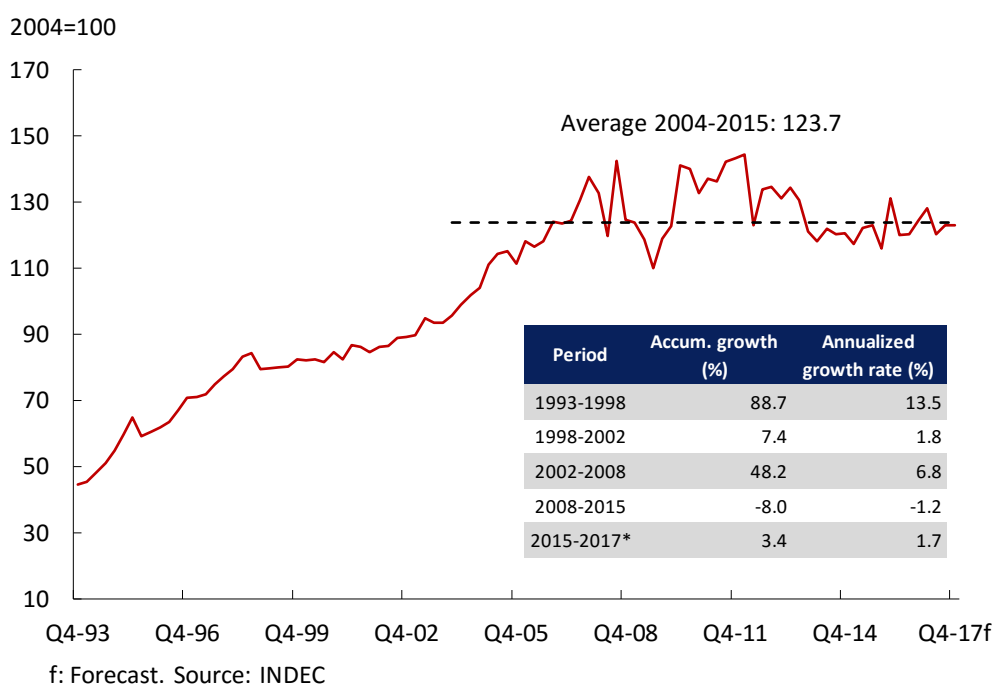
Figure 3.13 | Variation factors of goods trade balance*



Notes: *11 months of 2017 vs 11 months of 2016. Source: INDEC

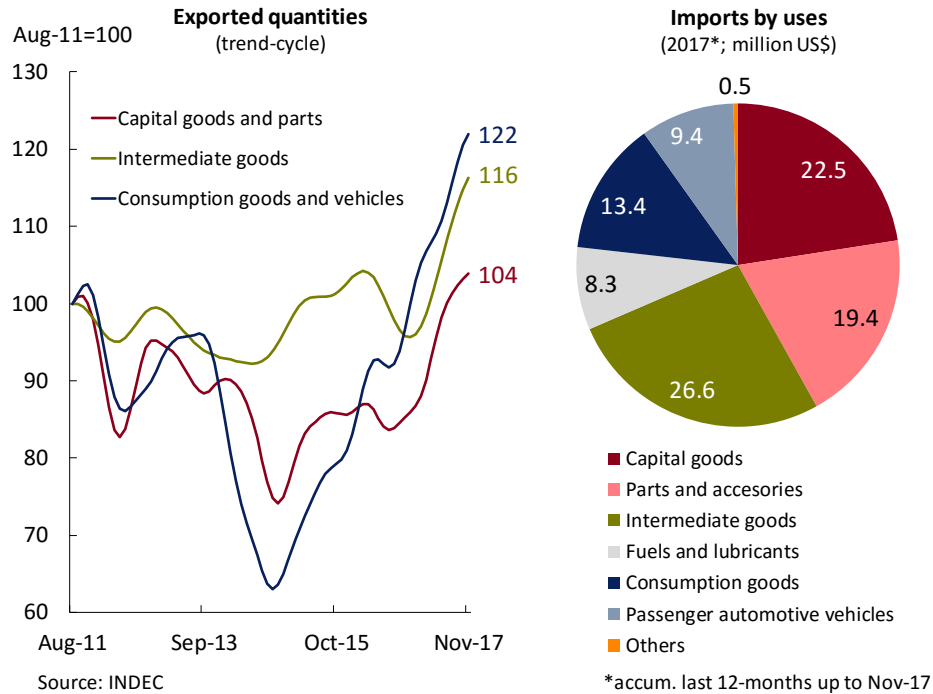
Exported volumes have grown in the last two years, reaching levels similar to those recorded in 2006–2007, but they are yet to break the 2004–2015 tendency towards stagnation (see Figure 3.14). During the first eleven months of 2017, the growth in external sales of industrial manufactures (10 percent year-over-year), was offset by the fall in exports of primary goods (6.2 percent year-over-year) and agricultural manufactures (2.3 percent year-over-year). Facing a record-setting harvest, the fall in the export of primary products was mainly accounted for by the retention of soybean stocks by producers. In the case of agricultural manufacture exports, the behavior was mixed, with increases in meat products (22 percent year-over-year) and falls in dairy products (27 percent year-over-year) and soybean products (3 percent year-over-year).

Figure 3.14 | Volume exports of goods and services



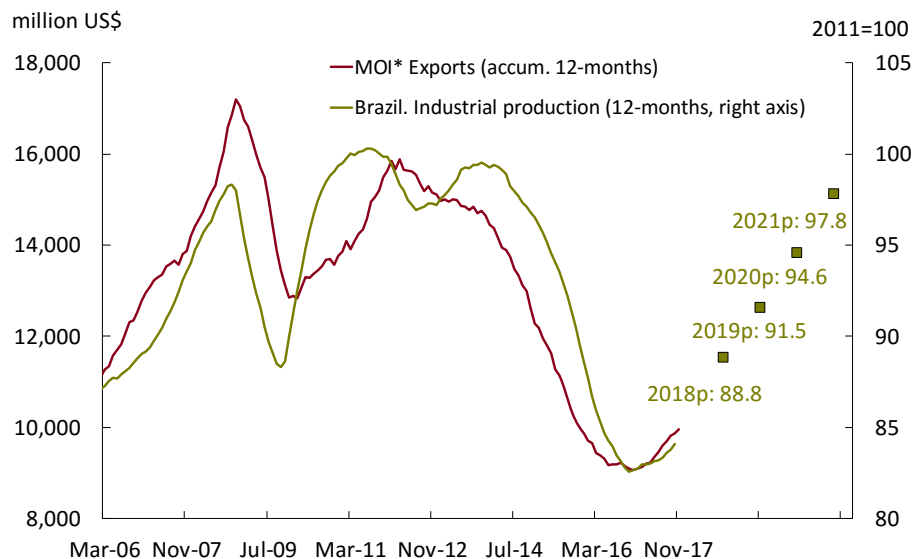
Imported volumes of goods continued to grow and are now at record levels relative to economic activity. It is necessary to mention the dynamic nature of external purchases of capital goods and their parts, associated to the strong investment process which characterizes the current phase of expansion. There was also a strong contribution from consumer goods and automobiles imports, favored by the elimination of distortions in the international trade of those products, but with a lower weight in total national imports (see Figure 3.15.)

Figure 3.15 | Performance and composition of goods imports



In the medium term, it is expected for the external accounts to continue to reflect the dynamic nature of domestic demand. Imports will continue to grow in all uses, particularly those associated to the investment and production process. Export categories with more favorable prospect in the current circumstances are those which could benefit from the greater projected growth in economic activity in our main trading partners. Particularly, industrial manufactures will benefit from the recovery in industrial activity in Argentina’s main trading partner, Brazil (see Figure 3.16).

Figure 3.16 | Manufacturing exports and industrial production in Brazil



Note: *Excludes vehicles, gold and biodiesel.
Source: Thomson Reuters, FocusEconomics and INDEC

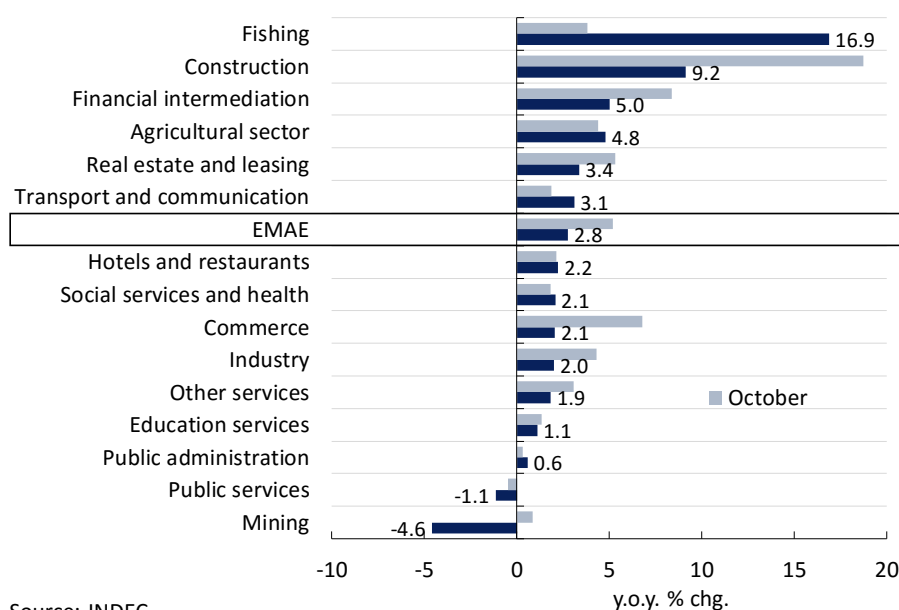
3.1.5 Productivity Increases and is Widespread Among Sectors

Economic growth was broad-based among productive sectors throughout 2017. The average in the diffusion index, which records the percentage of categories which grew month after month, was close to 59 percent between January and October.

Some of the most dynamic activities of the year were fishing, construction, financial intermediation, agriculture, and real estate services. Construction continues to be driven by public and private works. Financial intermediation was driven by the decrease in expected inflation, which makes it possible to extend the credit horizon, the implementation of measures aimed at facilitating the operation of the banking system¹², and the strong demand of UVA-denominated loans, which is growing more than 90 percent per year. Agricultural production continues to respond positively to the removal/reduction of export duties and to the trade and exchange normalization, besides the high level of stock withholding, which affects grain exports.

The only sectors which contracted on average in January-October relative to the same period of the previous year were electricity, water and gas utilities, and mine and quarry operations. The former sector was affected by the fall in residential demand, due to higher temperatures relative to the previous year, and the reduction in subsidies. In the latter case, international oil prices in the period were not profitable enough to break the declining trend in production seen since 1998, while mining activity is falling as a result of the reduction of exploration tasks in previous years (see Figure 3.17).

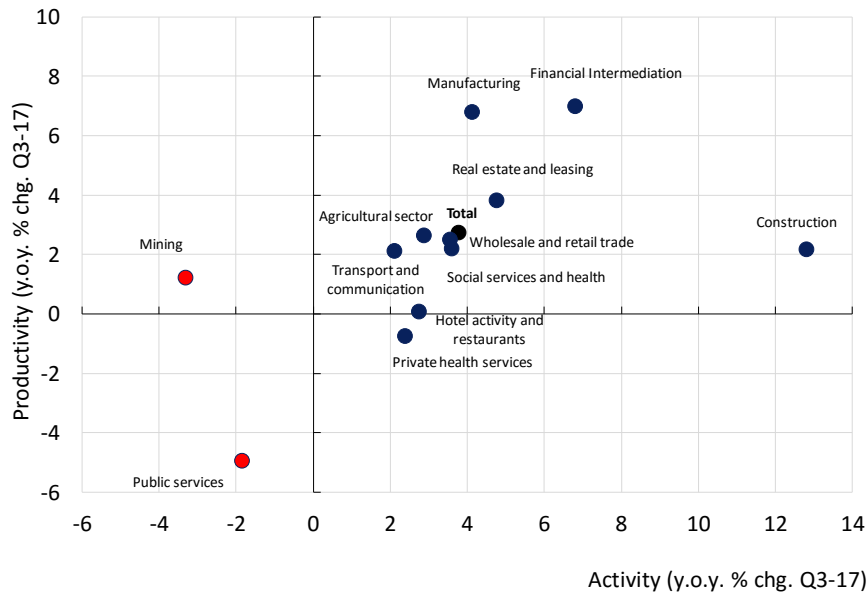
Figure 3.17 | Economic growth by sectors



Growth was supported by an improvement in productivity per registered worker (2.7 percent year-over-year), consistent with the more prominent role played by investment. Productivity increases were widespread at the sectoral level (see Figure 3.18).

¹² Asset and liability rates fixed by financial institutions were liberated. The possible uses of lendable capacity available in foreign currency were broadened, thus preventing currency mismatches in balance sheets.

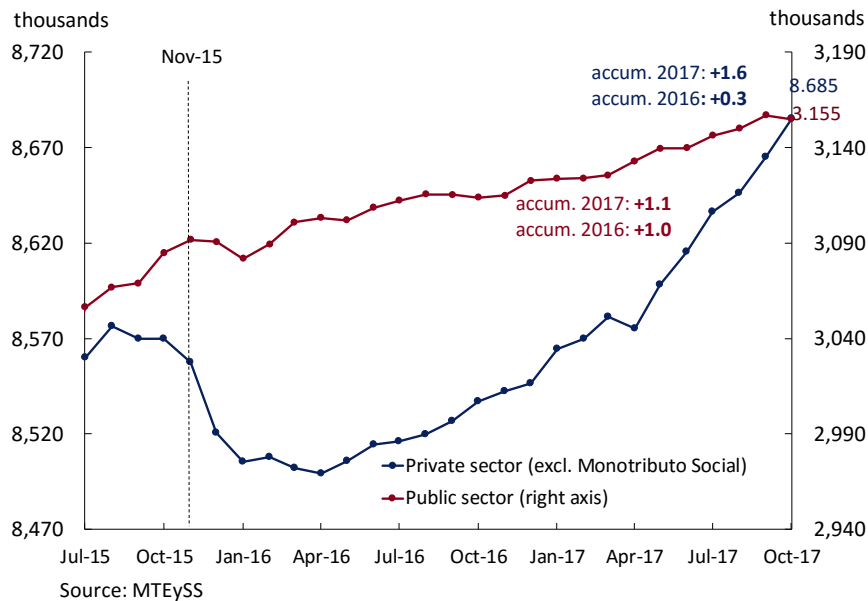
Figure 3.18 | Economic growth and productivity (GDP over formal employment) by sectors



Source: INDEC and MTEySS

Throughout the year, sectoral employment continued to be driven by construction (8.5 percent year-over-year), electricity, water, and gas (2.7 percent year-over-year) and fishing (1.6 percent year-over-year), while in the case of services, the most dynamic sectors were hotels and restaurants (2 percent year-over-year) and community, social, and personal services (1.5 percent year-over-year). These were followed by real estate, business and rent services (1.1 percent year-over-year), and trade and maintenance services (1.0 percent year-over-year), which grew moderately. Since April, 2017, job creation accelerated, driven by the more dynamic nature of the private sector, which accounted for 81 percent of new registered jobs (see Figure 3.19)¹³.

Figure 3.19 | Evolution of formal employment



Source: MTEySS

¹³ As of October, 2017, 73.4 percent of registered employment is accounted for by the private sector: 0.2 percentage points above the level of December, 2016.

Unemployment and sub-employment rates did not record significant changes between the third quarter of 2016 and the third quarter of 2017, as the labor supply and the employment rate increased similarly (0.3 percentage points).

At the end of the third quarter of 2017, there was a slight improvement in the distribution of per capita income¹⁴, driven by the deceleration of inflation and the measures aimed at improving the available income of the most vulnerable sectors, such as the reimbursement of VAT to pensioners and recipients of the Universal per-Child Subsidy. This improvement took place against the backdrop of a recovery in real wages. In particular, the wages of registered private workers increase 5.3 percent year-over-year in real terms, on average, in July-September, 2017¹⁵.

3.2 Growth Prospects for the Next Two Years Consolidate

The economy completed a year of uninterrupted growth at an annualized rate of 4 percent during 2017. The BCRA projects for this sustained growth to continue, with less volatility, leaving behind the phase of trend stagnation in the GDP. This view is in line with the estimations included in the National Budget Law of 2018, which considers a growth rate of 3.5 percent for 2018-2019, and is shared by the participants of the Market Expectations Survey, who projected that the economy will continue to expand at annual rates of 3.2 percent, 3.3 percent, and 3.2 percent in 2018, 2019, and 2020, respectively. The GDP increases expected for the next few years by analysts imply a break in the long-term growth trend of the economy (see Figure 3.20).

At the end of 2015, a series of measures was adopted aimed at correcting the macroeconomic imbalances, which made it possible to resume a path of growth, with increases in employment, productivity, and a prominent role for investment. The tax reform bill passed recently and the agreements reached with the provinces are aimed at reducing those taxes affecting the economy's competitiveness, particularly distortive taxes, and increasing the yield of capital¹⁶. These structural reforms are important to drive the economic potential of Argentina in a sustained way (see Exhibit 1 / Impact of structural reforms on productive sectors).

The government announced fiscal targets which imply a reduction in the primary deficit of the national non-financial public sector from 3.9 percent of GDP (0.3 percentage points below the target foreseen for 2017) to 3.2 percent in 2018, 2.2 percent of GDP in 2019, and 1.2 percent of GDP in 2020. A gradual reduction of the tax burden is projected, based on the recently-passed tax reform and the gradual adjustments foreseen for export duties on the soybean complex. National primary expenditure will fall approximately 1 percentage points of GDP in 2018, while the gradual reduction in subsidies, particularly for energy and transportation, is expected to continue. Moreover, expenditure in social aid will increase in real terms in 2018. Investment in infrastructure will continue to increase, supported by efforts under the PPP system promoted by the government.

¹⁴ According to the INDEC, the Gini coefficient of the per capita household income, in urban conglomerates, decrease from 0.451 to 0.427 between the third quarter of 2016 and the third quarter of 2017.

¹⁵ According to data from the Labor Ministry, based on the Argentine Integrated Pension System (SIPA), deflated by the national CPI.

¹⁶ The Argentine tax system is characterized by the existence of strongly-distortive taxes, such as the tax on bank debits and credits, the gross income tax, and export duties.

Productive factor utilization remains below a level which would cause inflationary pressures, a dynamics which will continue to be monitored by the BCRA. It is estimated that, in 2017, the GDP gap fell to -1.6 percent, from a value of -2.8 percent in 2016 (see Exhibit 2 / The output gap: a small multivariate model). This decrease is the result of a growth rate of approximately 1.6 percent in potential GDP, defined as that which would exist if there were no inflationary or deflationary pressures, which was below the one the GDP would have recorded in 2017, according to estimations. Thus, there is a perception of a trend towards the bridging of the GDP gap, but without signs of inflationary pressures.

Figure 3.20 | GDP trend projected using REM forecasts

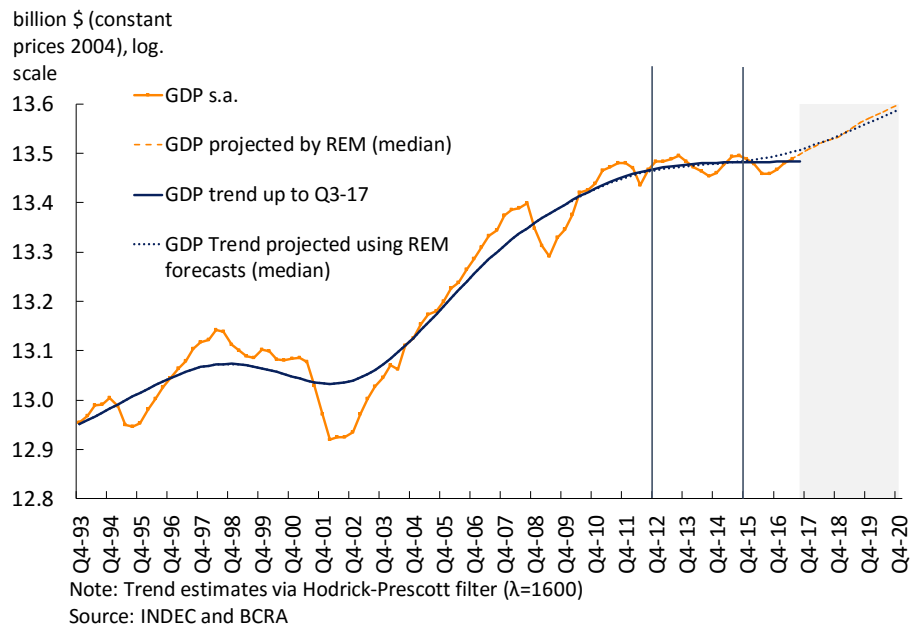


Exhibit 1 / Impact of Structural Reforms on Productive Sectors

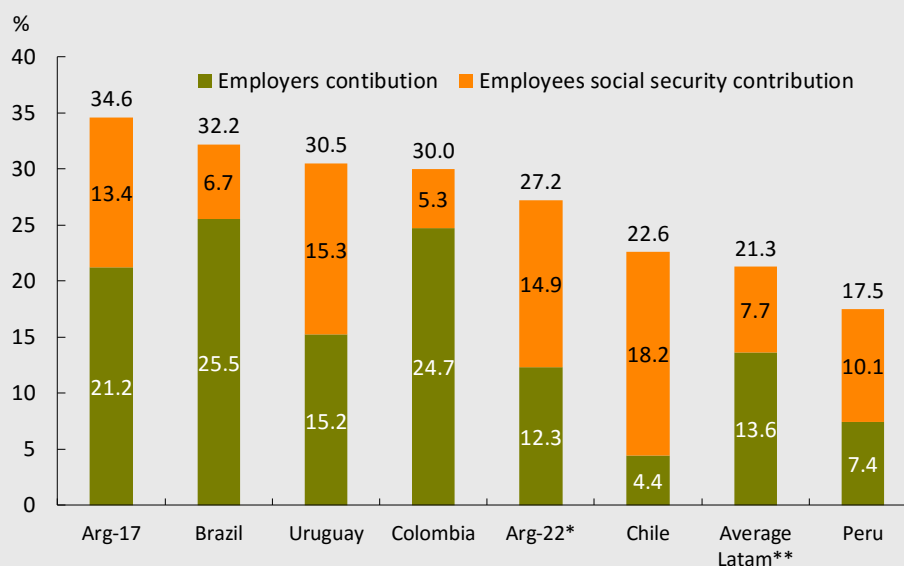
During the period 2011-2015, supply restrictions in the Argentine economy were evident in a GDP that showed high volatility around a stagnant trend, while labor productivity fell markedly.

Since late 2015, the Government has adopted important measures that may be classified based on two axes: the correction of macroeconomic imbalances, and the beginning of a structural reform process aimed at sustaining growth over the next few years.

The economic literature shows that structural reforms can have a significant impact on productivity and GDP growth over the long term, through various channels operating on supply (Blanchard and Giavazzi, 2001; Alesina et al., 2005).

The first results of the macroeconomic corrections are the economic expansion at an average annual rate of 4 percent since mid-2016 with employment increases and a growing contribution from investment. In December 2017, in order to consolidate and sustain economic growth, the Government submitted to the Congress a series of tax reforms intended to improve competitiveness by favoring formal job creation, investment and exports. The Tax Reform Act was coupled with fiscal agreements with the provinces aimed at lowering distorting taxes.¹⁷

Figure I | Total Fiscal Wedge in Latin America



* Estimated; ** Unweighted average (20 countries)

Source: MTEySS and CEPAL (2017)

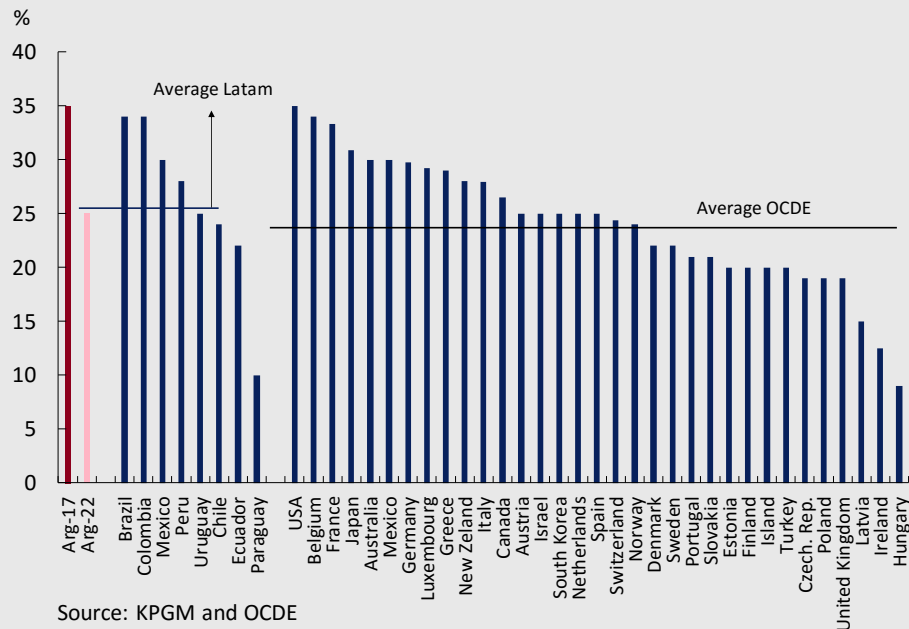
¹⁷ The Argentine tax system is characterized by strongly distorting taxes, such as the tax on banking debits and credits, the gross income tax, and export duties.

The most salient points in the tax reform include the setting of a rising non-taxable minimum per employer contributions that will reduce non-wage labor costs in 7.4 percentage points by 2022 (see Figure 1). This measure virtually entails the elimination of the tax for wages in the lowest deciles, which favors the reduction of informal labor.

Other relevant points of the tax reform are the lowering of the income tax rate for profit reinvestment (see Figure 2), the reduced time for VAT refunds, and tax on bank payment attributable as credit for income tax. The reduction of the legal persons tax should improve Argentina’s place in the ranking of countries with the lowest rates for companies, thus favoring the country’s appeal for investment.

Last, the agreement between the national Government and the provinces¹⁸ established the commitment to gradually lower the tax burden on gross income, which is highly distorting in the productive process¹⁹. Moreover, the provinces agreed to immediately remove any differential treatments based on corporate establishment, location of the taxpayer, or place of production of the goods.

Figure 2 | Corporate Fiscal Wedge in Latin America and OECD



Source: KPGM and OCDE

The adoption of structural reforms and their impact on the economy are medium- and long-term processes that prove indispensable to reach GDP per capita growth rates in a sustainable manner²⁰.

¹⁸ The national Government and the provincial administrations have signed the document titled *Consenso Fiscal*, Act 27.429.

¹⁹ The tax on gross income is a provincial tax applied as a percentage on companies’ turnover. Each jurisdiction has its own rates and parameters to decide whether a type of company must pay it or not. It is considered to be a highly distorting tax, because it applies a rate on turnover regardless of profits. Unlike the VAT, a good that goes through several production stages can be affected by the gross income tax at each of them, thus accumulating the burden, fact that compounds its distorting nature.

²⁰ Australia is an example of an economy that experienced a sustained growth in per capita income and attained advanced-country status in the process. There, the structural reform process lasted at least three decades, from the 70s to the 90s (Banks, 2005: Structural Reform Australian-style: Lessons for Others?).

Exhibit 2 / The Output Gap: A Small Multivariate Model

The potential output and the output gap are especially relevant variables for central banks. In particular, the output gap offers a picture of the cyclical conditions of the economy and of possible pressures, either inflationary or deflationary.

These are both non-observable variables that may be estimated with several methodologies — from methods based on the estimation of a production function to the use of different statistical filters. At the same time, two concepts of potential output can be distinguished. One of them refers to the economy's productive capacity in the absence of temporary shocks and with full resource utilization. Albagli and Naudon (2015) call this measure trend output. Based on this concept, the Central Bank currently uses the productive function approach. In the shorter term, the potential output is the output that is consistent with a stable inflation²¹. In this case, the potential output is usually estimated using univariate filters such as the Hodrick-Prescott (HP) filter, or the frequency filters in Baxter-King's and Christiano-Fitzgerald's versions. Recently, the use of multivariate filters and models has become more widespread, with various degrees of complexity and structure. Next, we describe and estimate a multivariate filter for Argentina — with annual periodicity for the period 1993-2017— applying the methodology developed by Benes et al. (2010), which has been adopted with a few variations by several central banks and international organizations²².

The model is estimated with Bayesian methods (combining *a priori* assumptions and data analysis) and using the Kalman filter²³. Thus, a data vector for observable variables (including GDP, unemployment and inflation²⁴) is broken into its (non-observable) components: trend and cycle. This yields the potential output, the output gap, the potential growth rate, the unemployment rate consistent with a stable inflation (or NAIRU²⁵) and the unemployment gap (understood as the difference between the NAIRU and the actual unemployment rate).

The model structure comprises three groups of equations. The first group describes output behavior and establishes the output gap and the potential output. The second group includes the Phillips curve, which traces inflation dynamics as depending on the output gap and inflation expectations, as well as a backward-looking component. Lastly, the third group of equations describes the labor market: the unemployment gap and its relation with the output gap.

GDP and growth:

$$\begin{aligned} y_t &= Y_t - \bar{Y}_t \\ \bar{Y}_t &= \bar{Y}_{t-1} + G_t + \varepsilon_t^{\bar{Y}} \\ G_t &= 0,15G^{SS} + 0,85G_{t-1} + \varepsilon_t^G \\ y_t &= 0,41y_{t-1} + \varepsilon_t^y \end{aligned}$$

²¹ There are, however, other points of view regarding potential output. In neo-Keynesian models, it is usually defined as the level associated with purely flexible prices and wages, that is, without nominal rigidities. On the other hand, even in a context of low, stable inflation, the output might be on an unsustainable path due to financial imbalances. For this reason, and particularly since the 2008 international crisis, institutions in countries with significant financial depth have developed “financially neutral” potential output calculations that include financial conditions indices (Borio et al., 2013; Melolinna and Tóth, 2016).

²² The countries whose central banks use or have used this technique include Brazil, Canada, Chile, Colombia, New Zealand, Peru, and the United Kingdom. The European Central Bank and international organizations such as the IMF and the BIS also perform estimations based on this approach.

²³ In particular, the regularized maximum likelihood method was used. For more information, see Ljung, L. (1999).

²⁴ Additionally, the model incorporates the steady state conditions as regards economic growth and unemployment, both assumptions were accomplished based on the historical average of the series as from 2004.

²⁵ Non-accelerating inflation rate of unemployment.

Phillips curve:

$$\pi_t = 0,5\pi_{t-1} + 0,5\pi_{t+1} + 0,32y_t + \varepsilon_t^\pi$$

Labor market:

$$u_t = \bar{U}_t - U_t$$

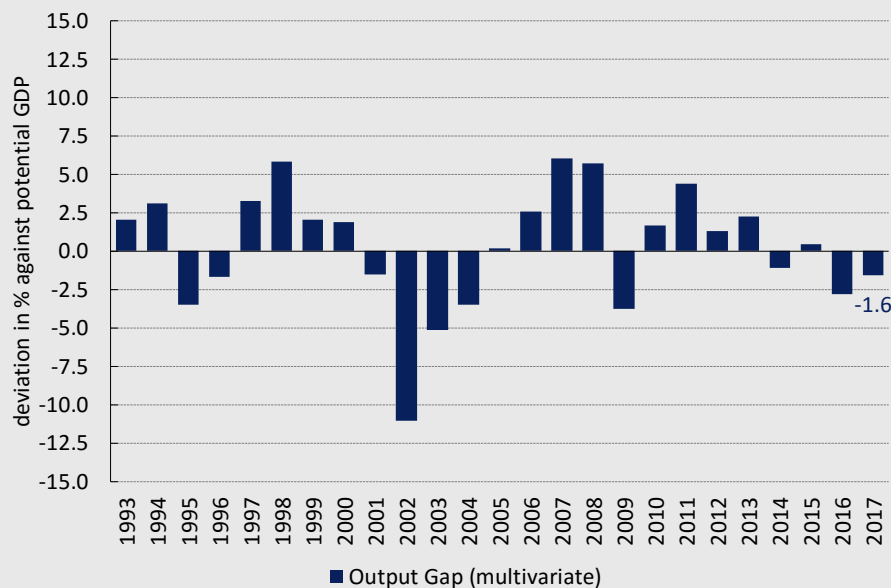
$$\bar{U}_t = (0,10\bar{U}^{SS} + 0,90\bar{U}_{t-1}) + \bar{U}_t^G + \varepsilon_t^{\bar{U}}$$

$$\bar{U}_t^G = 0,92\bar{U}_{t-1}^G + \varepsilon_t^{\bar{U}^G}$$

$$u_t = 0,23u_{t-1} + 0,48y_t + \varepsilon_t^u$$

Where y_t is the output gap, Y_t is the GDP level (in logs), \bar{Y}_t is the potential output (in logs), G_t is the potential growth rate, G^{SS} is the growth in stationary state, u_t is the unemployment gap, \bar{U}_t is the NAIRU, U_t is the unemployment rate, \bar{U}^{SS} is the unemployment rate in stationary state, and \bar{U}_t^G is the change in the NAIRU trend. Also, six types of shocks are defined: to potential output ($\varepsilon_t^{\bar{Y}}$), to the potential growth rate (ε_t^G), to the output gap (ε_t^y), to inflation (ε_t^π), to the NAIRU ($\varepsilon_t^{\bar{U}}$), to the NAIRU trend ($\varepsilon_t^{\bar{U}^G}$), and to the unemployment gap (ε_t^u).

Figure 1 | Output gap



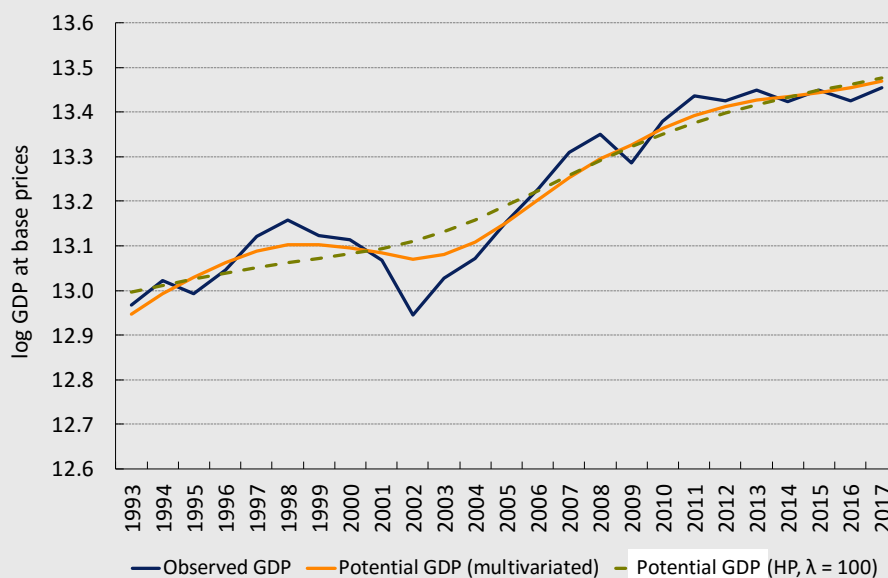
Source: BCRA, INDEC, DGEyC GCBA and DPEyC San Luis

Figure 1 shows the output gap, understood as the percentage deviation of output from its potential. The figure makes it possible to distinguish several different periods over the course of which the gap alternates its sign. The period 1999-2002, characterized by the economic crisis, concludes with a marked negative output gap. From 2003 onward, the economy takes on a recovery and growth path²⁶ and the output gap reverts to positive in 2005. The positive sign is maintained until 2015, the exception being the years 2009 and 2014, when the gap became negative due to the double effect of a positive potential growth and a fall in GDP (in 2009, this depression was associated with the effects of the international financial crisis; in

²⁶ The unemployment gap evolved in a similar fashion as regards its sign and trend in each year for the period 1993-2004. Over the course of the period 2005-2015, the variable had no negative year (whereas the output gap was negative in 2009 and 2014). However, the positive sign was reverted in the last two-year period (-1.1 percent in 2016 and -1.5 percent in 2017).

2014, among other factors, it was a consequence of the currency depreciation in January). Near the end of the sample, in 2016, a negative output gap (-2.8 percent) tended to closure in 2017 at -1.6 percent.

Figure 2 | GDP and Potential GDP



Source: BCRA, INDEC, DGEyC GCBA and DPEyC San Luis

Figure 2 shows the GDP and the potential output, estimated using the proposed methodology. As a reference for the latter variable, a calculation based on the HP filter is included HP²⁷. It can be seen that the series are similar at the end of the interval, the main differences occurring in the period 1996-2005, when the multivariate filter captures with more proximity the short-trend evolution of GDP at constant currency values. For this reason, the gaps are smaller in absolute terms compared to the calculation carried out with the HP filter.

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²⁷ Based on standard techniques for annual frequencies, a smoothing parameter $\lambda=100$ was chosen.

4. Prices

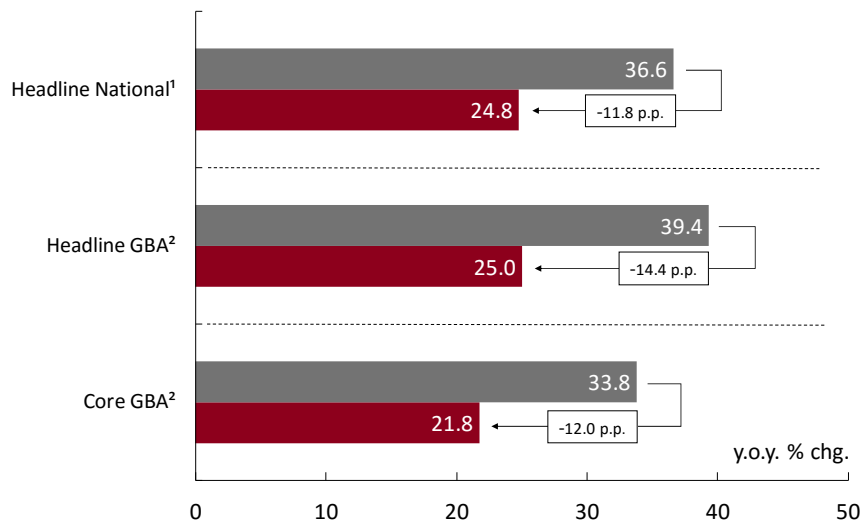
The year 2017 ended with a year-on-year inflation rate of 24.8 percent, thus marking a fall of 11.8 percentage points from the previous year²⁸. This slowdown took place within a context that included free-floating exchange rates and the normalization of public utility rates. The core inflation came in at 21.1 percent year-on-year, the lowest variation since 2009.

The core inflation, based on which the monetary policy operates, continued to decelerate over the last part of the year. This dynamic could be observed despite having been directly influenced by the increases in public utility rates that concentrated in December. The core component recorded a monthly average increase of 1.4 percent in the last quarter of 2017, the lowest value over the last six years.

Market analysts' inflation expectations suggest that disinflation will continue over the coming years. Estimates for 2018 were revised lightly upwards against the previous IPOM, basically due to an upwards correction in regulated prices.

4.1 Inflation slowed down in 2017

Figure 4.1 | Annual inflation. Headline and core



¹ National CPI linked with the CPI-NW (weighted average by expenditure based on the CPI's of the City of Buenos Aires, Córdoba and San Luis)

² Greater Buenos Aires CPI linked with the CPI of the City of Buenos Aires

Source: INDEC and Statistical Offices of the City of Buenos Aires, San Luis and Córdoba

Inflation slowed down significantly in 2017, showing a decrease of 11.8 percentage points against the previous year, as per the national indicator; and 14.4 percentage points, as per the CPI-GBA²⁹. In December, the core inflation came in at 21.1 percent year-on-year, 12.7 percentage points below that of 2016, the lowest value since 2009. The prices of regulated goods

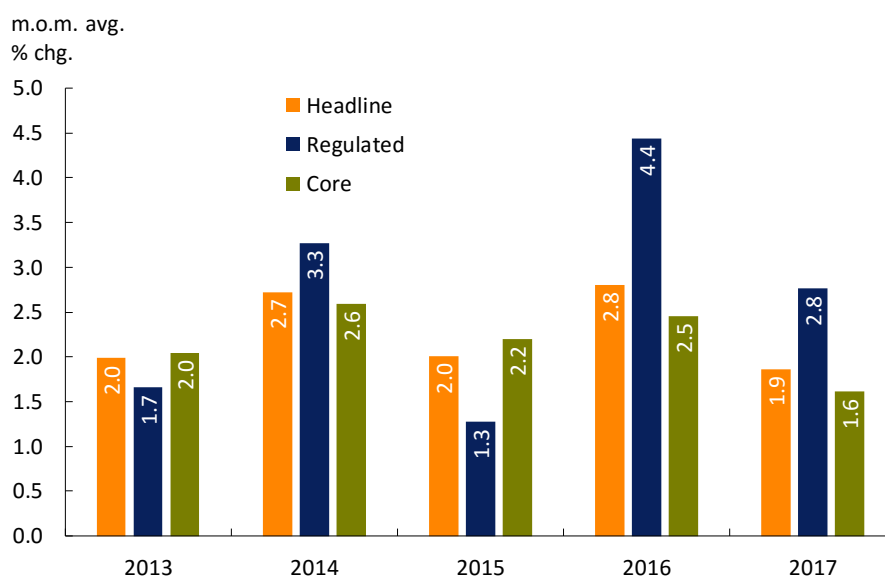
²⁸ The CPI national series developed by the INDEC as of Dec-16 was considered, combined with the nation-wide CPI estimated by the BCRA and based on the CPIs of the City of Buenos Aires, Córdoba and San Luis.

²⁹ CPI-GBA developed by the INDEC since April 2016, combined with the CPI of the City of Buenos Aires.

and services (38.7 percent year-on-year) were adjusted over the overall level, while seasonal goods and services (21.5 percent) increased in line with the core inflation (see Figure 4.1).

The disinflation level achieved in 2017 was due to a sharp downturn in the core inflation, within a context of normalization of the regulated services' relative prices. In 2017, the monthly average increase rate of the core inflation was 1.6 percent, the lowest value over the last years; meanwhile, the average growth of the Regulated components reached 2.8 percent. They accounted for more than 30 percent of inflation, a higher value than that of recent years with similar inflation rates (2013 and 2015; see Figure 4.2).

Figure 4.2 | Inflation. Average increase rate by component.



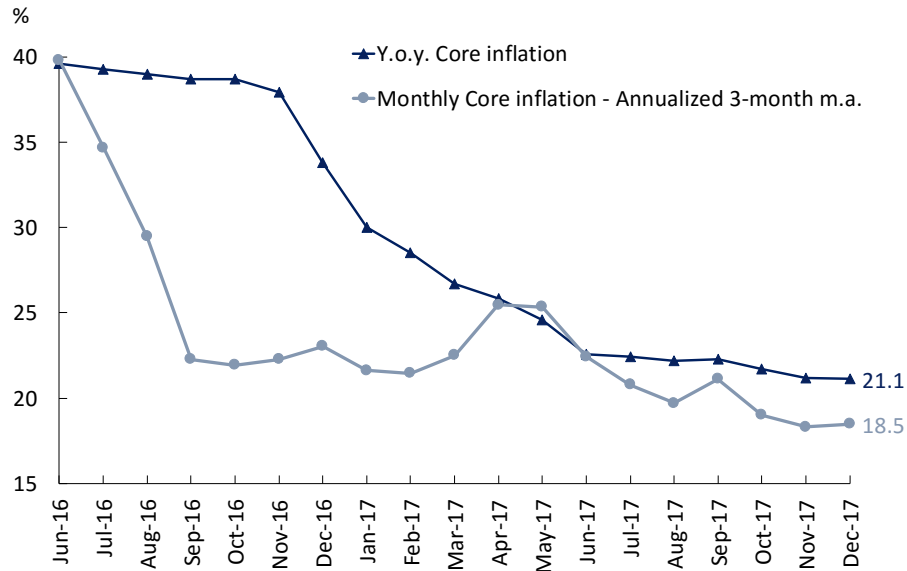
Source: INDEC and Statistical office of the City of Buenos Aires

In the last quarter, the monthly average variation of the CPI increased as a result of the adjustments made in Regulated components, thus boosting acceleration in year-on-year terms. Specifically, December saw simultaneous increases in public utility rates (electricity and gas), fuel and prepaid medical plans. In the last month of the year, the Regulated index recorded a monthly variation of 9.1 percent, leading to an inflation growth of 3.1 percent.

During the fourth quarter, the core inflation continued to slow down, despite the direct impact that increases in energy items (electricity and gas) had on building operating and maintenance costs³⁰. Some specific wage increases, such as the yearly bonus granted to domestic services and janitors, also contributed to increasing core inflation. The 3-month moving average of the monthly core inflation recorded its lowest value over the last six years, coming in at 18.5 percent in annualized terms (see Figure 4.3).

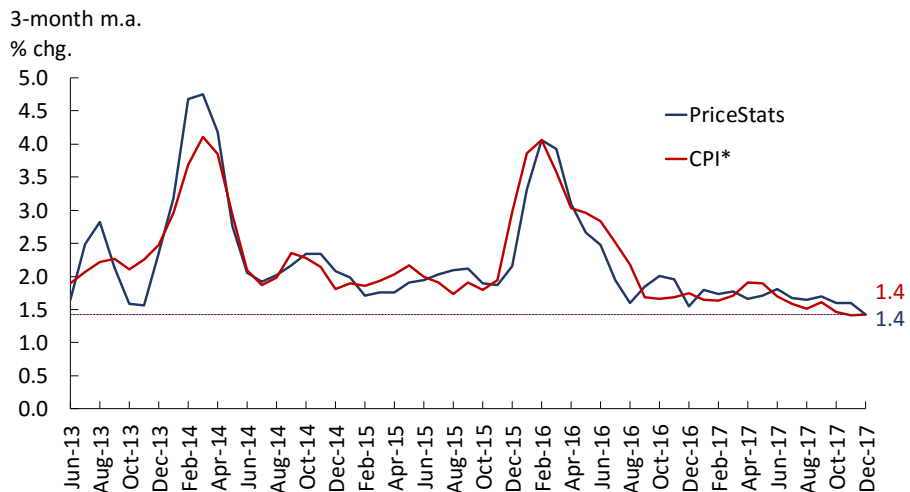
³⁰ As a result of the impact of electricity and gas increases on building operating and maintenance costs.

Figure 4.3 | Core inflation. CPI



Several high-frequency indicators that are strongly correlated with the development of the core inflation also showed a slowdown trend over the last months of the year. The index developed by PriceStats increased at a monthly pace of 1.4 percent in the last quarter of 2017, after having exhibited an upward 1.7 percent in the first part of the year (see Figure 4.4).

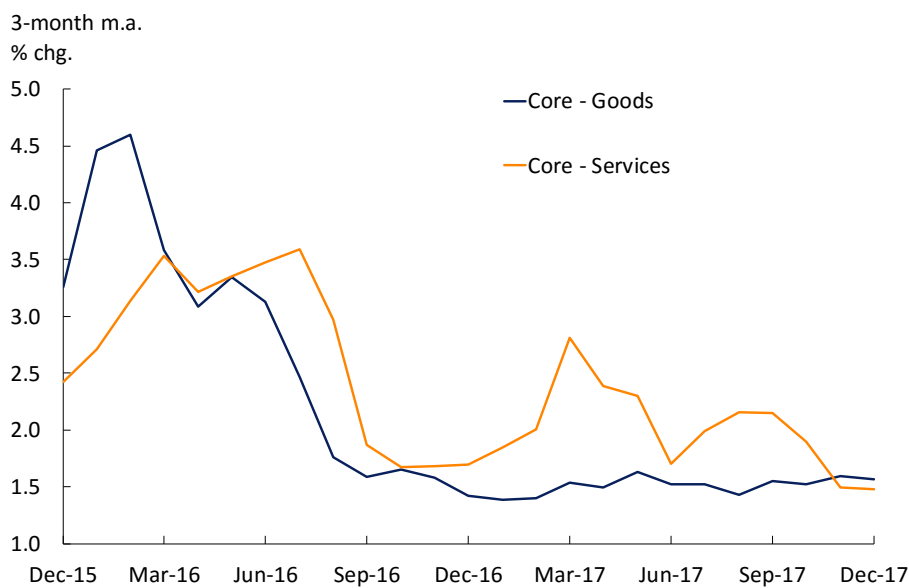
Figure 4.4 | Core inflation and leading indicators



*Note: The series corresponds to the CPI National coverage of INDEC from Jan-17, linked with the Greater Buenos Aires CPI up to Apr-16 and before with the BA CPI
 Source: INDEC, Statistical Office of City of Buenos Aires and State Street' PriceStats Aggregate Inflation Series

A breakdown of core inflation by goods and services³¹ shows a downturn in services during the fourth quarter of the year. This dynamics is consistent with the development of wages. Goods kept a relatively stable and limited pace of growth over the year, while decoupling from nominal exchange rate fluctuations. The relationship between the prices of private goods and services kept relatively stable during the last quarter (see Figure 4.5).

Figure 4.5 | CABA CPI. Core inflation decomposition

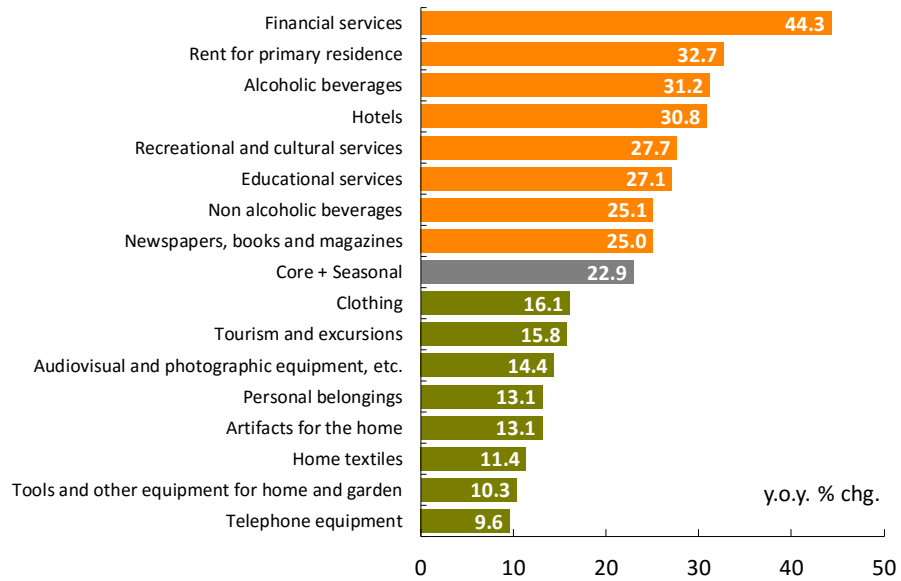


Source: Statistical Office of the City of Buenos Aires

The prices of goods mostly contributed to the interannual slowdown of the core inflation, leading to a relative decline of the prices of goods against those of private services. By December 2017, 25 percent of the item groups that showed the highest levels of year-on-year growth corresponded mostly to services, among which rents, financial services, tourist accommodation and leisure services stand out. At the other end, minor price increases are basically related to item groups including a high goods-component, which is more exposed to foreign competition and technological developments (see Figure 4.6). Specifically, food for household consumption, which accounts for approximately 18.6 percent of the core component plus the seasonal component, recorded a year-on-year increase of 20.5 percent, slightly below that of the aggregate average.

³¹ The CPI of the City of Buenos Aires will be used to analyze the core inflation's behavior in relation to goods and services, as there is no sufficient disaggregated information available to carry out such analysis based on the CPI developed by the INDEC. The dynamics of the prices of goods and services for both indicators is similar, both monthly and in annual accumulation variation terms.

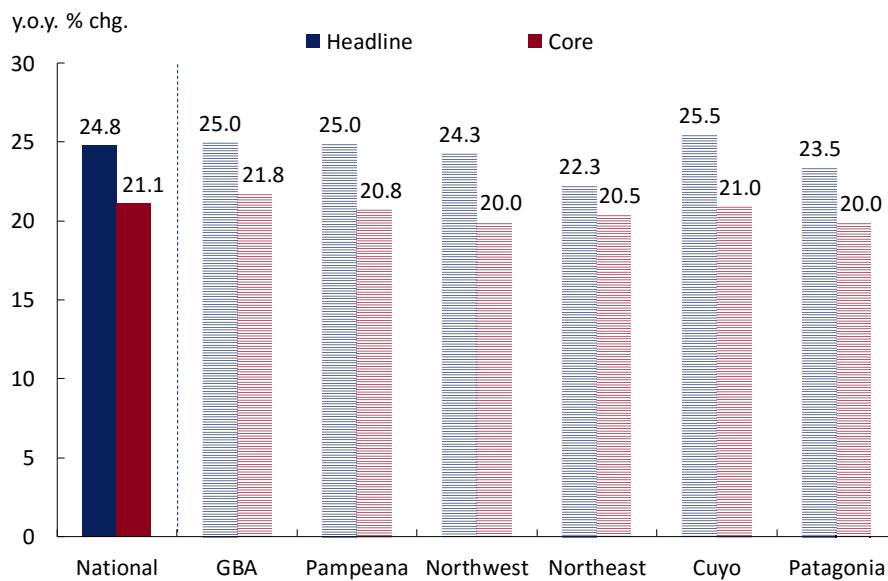
Figure 4.6 | 2017 City of Buenos Aires CPI by groups. First and fourth quartile



Source: Statistical office of the City of Buenos Aires

At a regional level, the core inflation was relatively uniform in 2017. However, some differences in the development of the regulated components made overall inflation slightly more heterogeneous. The Northeastern area had the lowest rise in the overall price level year-on-year, reaching 22.3 percent, while the Cuyo area presented the highest rise (see Figure 4.7).

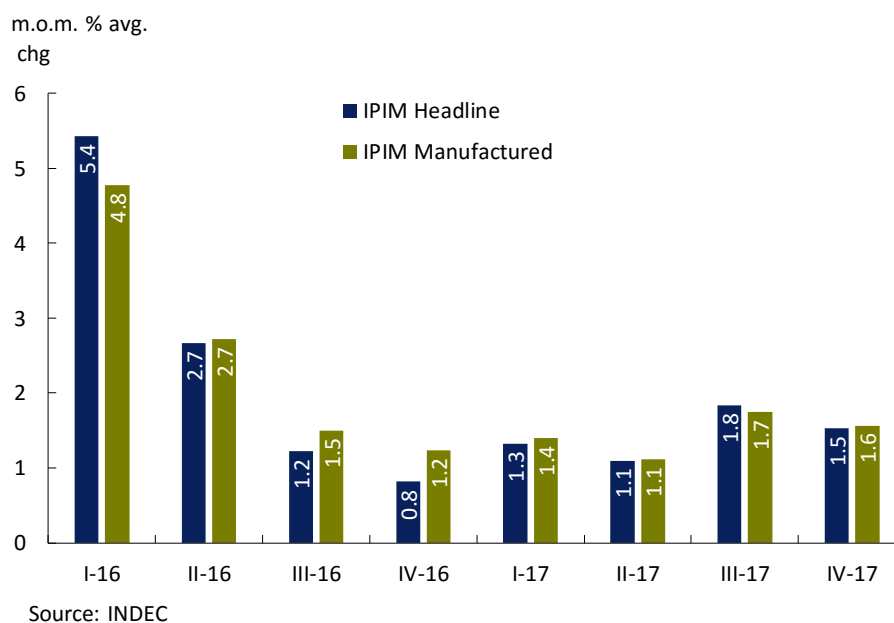
Figure 4.7 | Annual inflation by regions



Source: INDEC

At the end of 2017, wholesale prices³² rose by 18.8 percent year-on-year, 15.7 percentage points below the value reached in 2016. These prices, mostly tradable, increased to rates similar to those of the national CPI goods and ended 2017 with a year-on-year increase that came in at 6 percentage points below the consumer prices (national CPI). The average variation of the last quarter was 1.5 percent, which meant a deceleration of 0.3 percentage points with respect to the previous quarter. The majority of its components presented lower growth rates (see Figure 4.8).

Figure 4.8 | Wholesale price index. Headline and manufactured



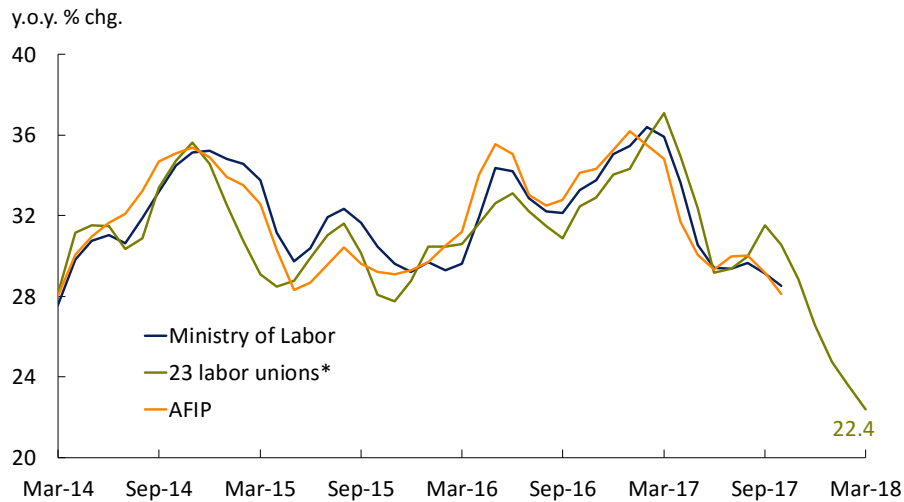
4.2 Nominal wages growth rate lessened

In the fourth quarter, the rise in nominal wages would have been lower than that of the previous quarter. This dynamics was caused by the structuring of the collective bargaining agreement, which practically did not include adjustments for the last months of the year.

Most clauses related to the adjustment or revision of the wage scheme, included in the collective bargaining agreement, did not come into effect because the inflation rate was below the wage increases agreed. At the end of 2017, the nominal wage would have reached a 2 percent increase above the cumulative inflation of the same year. At the beginning of 2018, the interannual wage increase rate would continue to decline (see Figure 4.9).

³² The domestic wholesale price index (DWPI) basket at market prices is mainly composed of goods.

Figure 4.9 | Nominal wages. Formal private sector



* The estimate of 23 labor unions is performed taking the weighted average of the salary of each labor union times the private formal employment of each economic sector. Only those labor unions that don't renew wage agreements during the first quarter of 2018 were considered.
Source: Ministry of Labor and AFIP

It is estimated that the modality applied to wage negotiations in 2018 will be the same as that of 2017, when the future dynamics of prices acquired more relevance than the past developments. In this context, wage negotiations are expected to be in line with the inflation target for this year. Moreover, clauses that allow making adjustments—in the event inflation exceeds a certain threshold— could be considered.

4.3 The path towards disinflation would continue in 2018

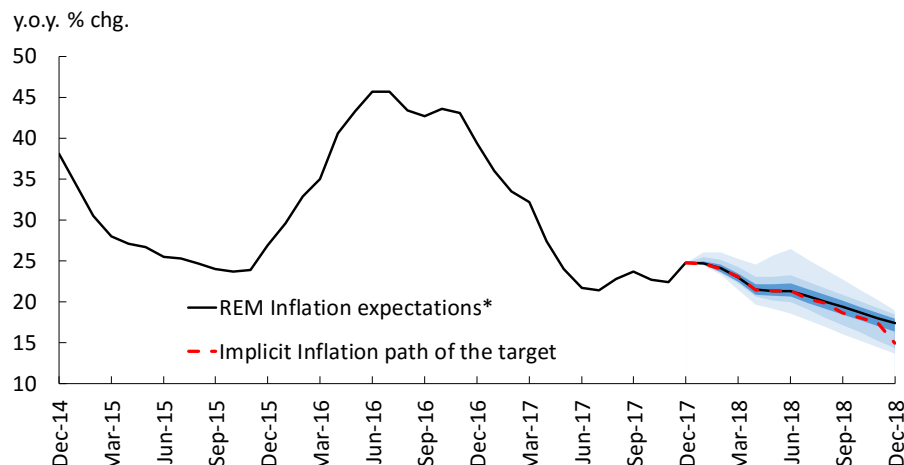
Market analysts' inflation expectations reflect the continuity of the disinflation process. According to the Market Expectations Survey (REM), inflation will come in at 17.4 percent by December 2018, 7.4 percentage points below that of 2017.

As regards the survey carried out in last September, the inflation rate expected for 2018³³ rose by 1.7 percentage points as a result of a higher than expected adjustment in the prices of the regulated services. The implicit REM projection about the regulated component rose to 25.8 percent by 2018 (+4.2 percentage points against the previous IPOM), while the expected core inflation increased to 0.9 percentage points at 14.9 percent year-on-year.

The new inflation target for December 2018 (15 percent year-on-year) falls within the expected inflation range of the REM (see Figure 4.10). However, the median market forecast exceeds the target by 2.4 percentage points. If the market forecast is met, the inflation rate for 2018 would be the lowest in the last nine years.

³³ These results correspond to the survey carried out between December, 22 and December, 28 at 9:00, time prior to the announcement of the modification of the inflation targets.

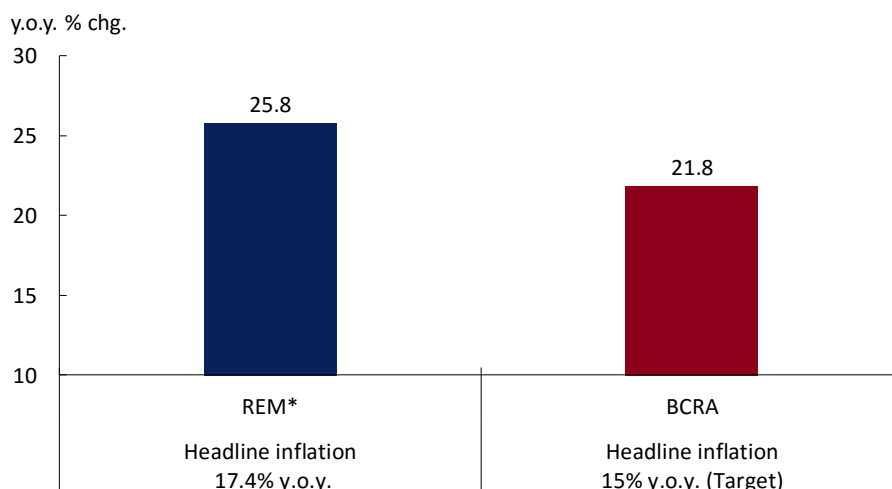
Figure 4.10 | Inflation expectations from the Market Expectations Survey (REM) and inflation path consistent with the target



Note: the inflation correspond to CPI of national coverage from Dec-16, linked with the Greater Buenos Aires CPI up to Apr-16 and backward with the CPI of the City of Buenos Aires. For the second semester of 2018, months were linearly interpolated.
 Source: INDEC, Statistical Office of the City of Buenos Aires and Market Expectations Survey (REM- BCRA, Dec-17)

The variation of the Regulated components implicit in the REM projections exceeds the BCRA estimates based on the information available to date. As regards public utility and transport rates, there is information available through public hearings and announcements. For the rest of the items included in the Regulated components, a consistent path with a fixed target for the present year is assumed. Based on the above information, the anticipated increase in the Regulated components in 2018 would be 21.8 percent year-on-year (see Figure 4.11).

Figure 4.11 | Inflation of Regulated items. Implicit in the Market Expectations Survey (REM-BCRA) and BCRA estimation. December 2018



* Expected y.o.y. implicit change from the median of the estimations of the Headline inflation (17,4% y.o.y.) and Core (14,9% y.o.y.) shown by the REM - December 2017.
 Source: INDEC and Market Expectations Survey (REM- BCRA, Dec-17)

Most anticipated increases for the whole year would be concentrated on the first semester. Public transport rates will increase in February, April and June. The first upgrade of the public transport corresponds to the implementation of the “RED SUBE” (Unified Electronic Ticket System Network), a scheme under which discounts are applied on integrated rides. Due to the introduction of this new system, rate increases to be faced by consumers will be lower on average (see Exhibit 3 / How much will public transport rates increase?). Electricity and gas rates would be first adjusted in February and April, respectively (see Table 4.2).

Table 4.1 | Expected increase of regulated services in 2018. National CPI

	First quarter		Second quarter		2018	
	% chg.	inc. (in p.p.)	% chg.	inc. (in p.p.)	% chg.	inc. (in p.p.)
Regulated	13.5	3.1	7.3	1.8	21.8	5.1
Public services	20.2	1.6	10.9	1.0	33.3	2.8
Other regulated	9.4	1.5	5.2	0.8	15.0	2.3

*Electricity, Gas, Water, Bus, Train and Subway

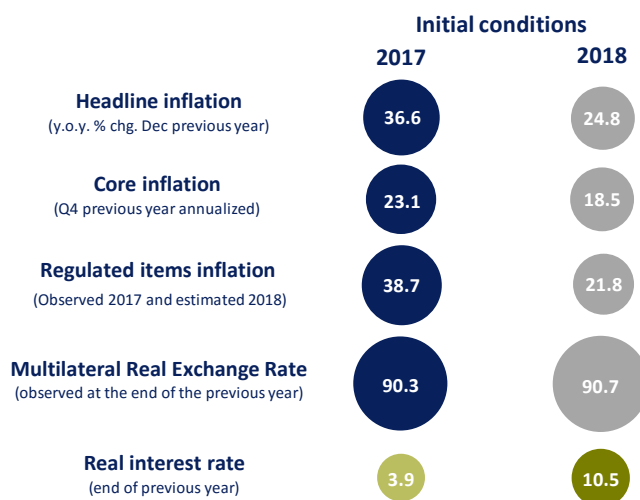
Table 4.2 | Expected increase of regulated services for the first semester of 2018. (National CPI; monthly % chg.)

Service	18-Jan	Feb-18	Mar-18	18-Apr	May-18	Jun-18	Q1-2018
Water	-	-	-	-	20%	-	20%
Electricity	-	16%	-	-	-	-	16%
Gas	-	-	-	25%	-	-	25%
Bus	1%	8%	1%	6%	1%	6%	25%
Train	-	3%	-	5%	-	4%	12%
Subway	-	-6%	-	21%	-	6%	21%

Source: BCRA

The initial conditions for meeting the inflation targets for 2018 are more favorable than in the previous year. The overall year-on-year variation came in at 24.8 percent in December 2017, which meant 11.8 percentage points below that of 2016; the annualized core inflation for the last quarter of 2017 was 18.5 percent (vs. 23.1 percent in 2016); the forecasted adjustment of the Regulated components for 2018 is significantly lower than the increase observed in 2017; the Multilateral Real Exchange Rate remained practically unchanged in 2017, and the bias of the monetary policy at the end of 2017 is more contractive than that of the previous year in the same period (see Figure 4.12 and Chapter 5. Monetary Policy).

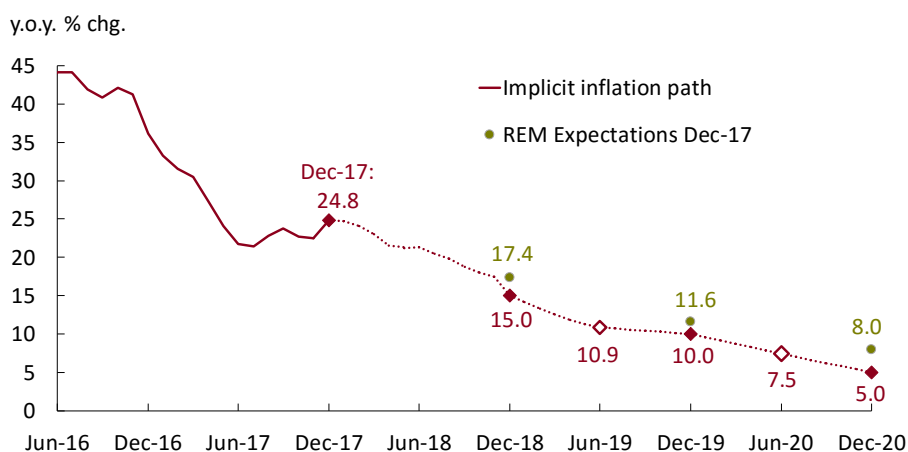
Figure 4.12 | Initial conditions



Source: BCRA

By 2019 and 2020, the REM forecasts a downward inflation of 11.6 percent year-on-year and 8 percent year-on-year, respectively, in line with the new inflation targeting regime. The forecasts indicate 1.6 percent above the target by 2019, and 3 percentage points by 2020 (see Figure 4.13).

Figure 4.13 | Inflation targets and expectations. 2018-2020



Note: CPI of national coverage from Dec-16, linked with the Greater Buenos Aires CPI up to Apr-16 and backward with the CPI-NW (weighted average of the CPIs of the City of Buenos Aires, San Luis and Córdoba). To calculate the inflation path, the m.o.m. variations of the REM for the first semester of 2018 were used. For the second semester of 2018, months were linearly interpolated.
Source: INDEC, Statistical Offices of the City of Buenos Aires, San Luis and Cordoba and Market Expectations Survey (REM- BCRA, Dec-17)

Exhibit 3 / How Much Will Public Transport Rates Increase?

The Ministry of Transport has established that, as from February this year, new fees will be effective for passengers' public transportation in the metropolitan area of Buenos Aires. Subsequent changes for April and June have also been announced. At the same time, the Red SUBE system has been put in place, which integrates all kinds of public transportation in the area (bus, train and subway) to offer discounts for those who make one or more combinations.

With the adoption of Red SUBE, the fee for the first means of transport used by a passenger will be paid in full. The second means of transport, used within the following two hours, will have a 50 percent discount, while only 25 percent of the fee of the third one will be paid. The increase established for February in the full price of train and bus tickets is roughly 33 percent. Therefore, for the sections where the 50 percent (25 percent) discount applies, the paid fee will be 33 percent (66 percent) lower than the prices paid before the increase. Subway fees will stay unchanged during February³⁴ for those who pay the full price, and fall 50 percent and 75 percent for the discounted fees.

Estimating the impact of these means of transport's price index on the CPI in February requires calculating the share of fees that will be paid in full and the share of those that will be paid with each type of discount. To that end, we use three different assumptions. Depending on the distribution assumption adopted, the increases in train and bus fees are estimated to increase 0 percent to 15 percent, while subway fees should fall 14 percent to 25 percent.

Table I | Impact of the increase in the transport cost on the February price index

	Feb-18		Assumption 1	Assumption 2	Assumption 3
	Train/Bus	Subway			
Full price	33%	0%	75%	65%	55%
50% off	-33%	-50%	20%	28%	35%
25% off	-67%	-75%	5%	8%	10%
Train/Bus variation			15.0%	7.5%	0.0%
Underground variation			-13.8%	-19.4%	-25.0%
Train, Bus and Underground index variation in Great Buenos Aires			13.9%	6.5%	-1.0%

Source: BCRA

The index weights for each of these means of transport are needed to estimate the effect on the Great Buenos Aires area (GBA) CPI, assuming that the INDEC takes these discounts into consideration. The current published methodology of the GBA CPI account for the weight of public transport, namely, 2.8 percent, but does not break down its components (bus, train, subway, and taxi cabs). In order to estimate the weight for each of these components, we took into account their relative share in the GBA CPI based in 2008. According to said report, bus represented 67 percent of the aggregate, while trains 8 percent, subways 3 percent, and taxi cabs the remaining 22 percent. Using this information and the current weight for passenger public transportation, the weights in the GBA CPI should be 1.9 percent for buses, 0.2 percent for trains, 0.1 percent for the subway, and 0.6 percent for taxi cabs.

³⁴ The increase is scheduled for April and June.

Based on those weights, the GBA public transport index (excluding taxi cabs) should record a change of -1 percent to 14 percent in February, depending on the assumption adopted. Since the GBA has a nearly 50 percent weight in the national index, the change in this component in the latter should be roughly cut in half, with an incidence between 0 and 0.2 percentage points.

Exhibit 4 / Exchange Rate Pass-Through: International Evidence

The relationship between the changes in the nominal exchange rate and the domestic price movements is very significant for monetary policy. Typically, this relationship is studied through pass-through ratios, which estimate the price levels' reaction to changes in the nominal exchange rate. Conceptually, these ratios change according to the underlying cause of the initial movement in the exchange rate. For instance, nominal shocks are associated with a higher exchange rate pass-through while real shocks, such as changes in terms of trade, changes in the demand, etc., are associated to lower pass-through ratios. Thus, in inflationary economies with a prevalence of nominal shocks, the pass-through can be expected to be higher than in economies with inflation targeting. This exhibit assesses the international evidence on the effect of the adoption of inflation targeting on the exchange rate pass-through, making a distinction between nominal and real shocks. The goal is to understand what can be expected for the relationship between the exchange rate and prices in Argentina with the consolidation of a low, stable inflation, under an inflation targeting regime.

The sample used includes five emerging countries that adopted an inflation targeting regime after a long period of moderate to high inflation. The following table shows the period under analysis for each economy³⁵ and its year-on-year average inflation.

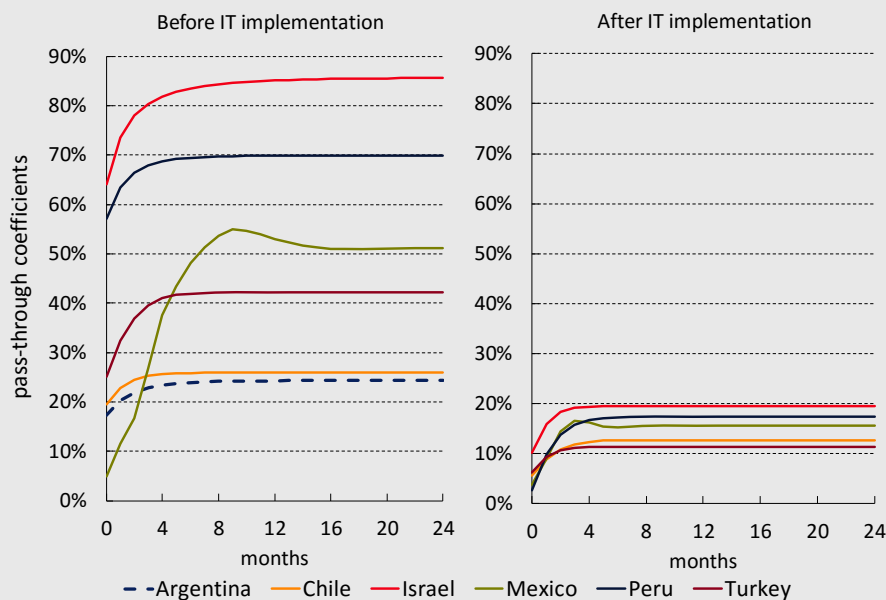
Table I | Average inflation before and after Inflation Targeting adoption.

	Chile		Israel		Mexico		Peru		Turkey	
	Pre MI 1983-1998	Post MI 2000-2017	Pre MI 1983-1996	Post MI 1998-2017	Pre MI 1989-2000	Post MI 2002-2017	Pre MI 1983-2001	Post MI 2002-2017	Pre MI 1987-2005	Post MI 2006-2017
CPI Inflation	15.7%	3.3%	70.2%	1.9%	19.2%	4.2%	684.8%	2.9%	60.9%	8.5%

Source: BCRA from BIS data

A vector autoregressive model can be used to estimate the inflation response to a nominal exchange rate shock. Figure 1 shows the fraction of the innovations in the exchange rate that are passed through to prices, as well as the time this process takes, before and after the adoption of the inflation targeting regime. In Israel, for example, before the adoption of inflation targeting, prices' immediate response to a depreciation of the currency was 64 percent, which would increase to 86 percent over time. After the adoption of the inflation targeting regime, the numbers fell to a 10 percent short-term effect and a 19 percent long-term effect. The same pattern was observed for all the countries in the sample.

³⁵ The dates of adoption of the inflation targeting regime were taken from Hammond, Gill (2012). "State of the art inflation targeting," Bank of England.

Figure I | Unconditional exchange rate pass-through to consumer prices coefficients

Source: BCRA from BIS data

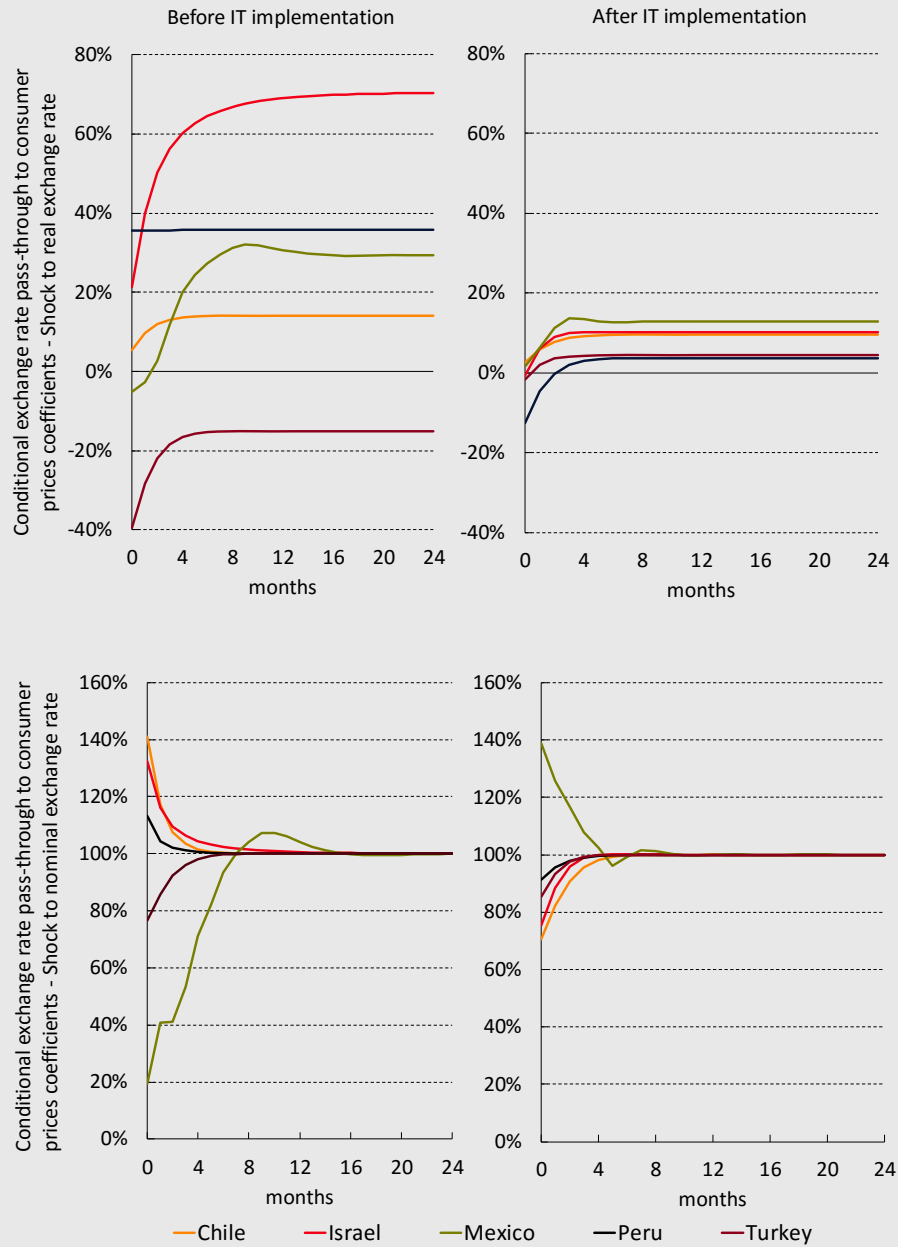
A key aspect of this monetary regime is that it is intended to reach a low, stable inflation without resorting to exchange rate as a nominal anchor. By announcing the inflation targeting, together with a set of measures aimed at meeting those goals, central banks succeed at leading the private sector to anchor its inflation expectations, and the nominal exchange rate to float as a reflection of the prevailing conditions of demand and supply in the economy. Together, these two aspects drive a decoupling of the nominal exchange rate and the domestic price level, and, therefore, a reduction in the exchange-rate pass-through ratios.

Understanding the reasons behind this reduction in the pass-through, as mentioned above, requires considering the primary causes for movements in the exchange rate. Particularly, if different drivers create different exchange rate and price dynamics, the associated pass-through will differ as well. Therefore, it is clear that the pass-through from the exchange rate to prices must be studied as a phenomenon conditional on the cause behind the exchange rate movement.

Although there are multiple determinants of the exchange rate, a simple but intuitive way to group these is by separating real from nominal factors. A structural vector autoregressive model including the real and nominal exchange rate allows us to distinguish real determinants from nominal ones, identifying the latter as those that have no effect on the real exchange rate in the long run.³⁶ This yields impulse response functions for each kind of shock, based on which the conditional pass-through is computed. Figure 2 shows the pass-through ratios determined by both real and nominal shocks, distinguishing the before-and-after of the adoption of inflation targeting.

³⁶ For more detail on this methodology, see Enders and Lee, 1997, "Accounting for real and nominal exchange rate movements in the post-Bretton Woods period," *Journal of International Money and Finance*.

Figure 2 | Conditional exchange rate pass-through to consumer prices coefficients



Source: BCRA from BIS data

Two noteworthy empirical regularities shown in Figure 2 are (a) the fact that the pass-through to inflation of the depreciations caused by a real shock is lower than the one caused by a nominal shock, and (b) that the pass-through to prices from both kinds of shocks tends to be lower under an inflation targeting regime. It should be noted that a negative pass-through from real shocks is to be expected under managed exchange rate regimes. This is because negative real shocks require real depreciations to accommodate the shock. If the nominal exchange rate does not depreciate enough because of being managed, the real

devaluation will take place due to the fall in prices, which explains the negative pass-through.³⁷ Extreme examples of this are Argentina after the devaluation in Brazil, or Greece during the crisis in Europe in 2010.

Another empirical regularity is that, with inflation targeting, nominal shocks are much less significant. In fact, the percentage of the nominal exchange rate volatility attributed to nominal shocks falls after the adoption of inflation targeting, from 17 percent to 3 percent in Chile, from 60 percent to 8 percent in Israel, from 25 percent to 5 percent in Mexico, from 73 percent to 14 percent in Peru, and from 45 percent to 6 percent in Turkey. This is the merit of a monetary policy focused on reducing inflation volatility around the targeting.

These results explain why the pass-through of a depreciation to inflation is lower under an inflation targeting regime: first, the impact of a given shock is lower; and second, under an inflation targeting regime, nominal shocks are much less significant.

What are the implications of this analysis for Argentina? Unfortunately, the sample for Argentina in the inflation targeting period is too short to replicate this exercise. We can, though, compute the pass-through for Argentina in the period 2007-2015, included in the left panel in Figure 1. As can be seen, the pass-through in that period is comparable to the one in Chile, and somewhat lower than in Turkey, before the adoption of inflation targeting. Given the experience in those countries, where the pass-through was reduced to approximately the half with the new monetary policy, the outlook for the Argentine case points to a significant reduction in the pass-through of exchange rates movements to prices.

³⁷ These negative real shocks have more pernicious consequences for activity and employment when the nominal exchange rate cannot be properly adjusted. See, for instance, Schmitt-Grohe and Uribe, 2016, "Downward Nominal Wage Rigidity, Currency Pegs, and Involuntary Unemployment," *Journal of Political Economy*.

5. Monetary Policy

In December, 2017, year-on-year inflation was 24.8 percent, above the target set for the year (14.5 ± 2.5 percent). This deviation was accounted for by a monetary policy which loosened in late 2016 and early 2017, for a higher-than-expected persistence of inflation in nominal contracts, and by higher-than-expected increases in regulated prices.

The evolution of the inflation rate above the target in the first few months of last year led the BCRA to increase the contractive bias of monetary policy, thrice increasing the policy rate, which went from 24.75 percent in March to 28.75 percent in December, 2017, and intervening actively in the LEBAC secondary market, in order to raise the interest rate of those instruments.

The result of these decisions began to be seen in the second half of last year, when the three-month moving average of core inflation breached the monthly rate of 1.7 percent observed until then, and closed the year in a monthly 1.4 percent (an annualized 18.5 percent). Moreover, the year-on-year inflation rate posted in December of last year a 11.8 percentage point fall relative to the same month in the previous year, while inflation expectations remained anchored over the year and with a clear decreasing trend for the next few years. Unlike other disinflation processes which took place in our country, in this occasion, the reduction in inflation is taking place without freezing utility fees, with free prices and exchange rate, with economic growth, and without a sustained real appreciation of the peso.

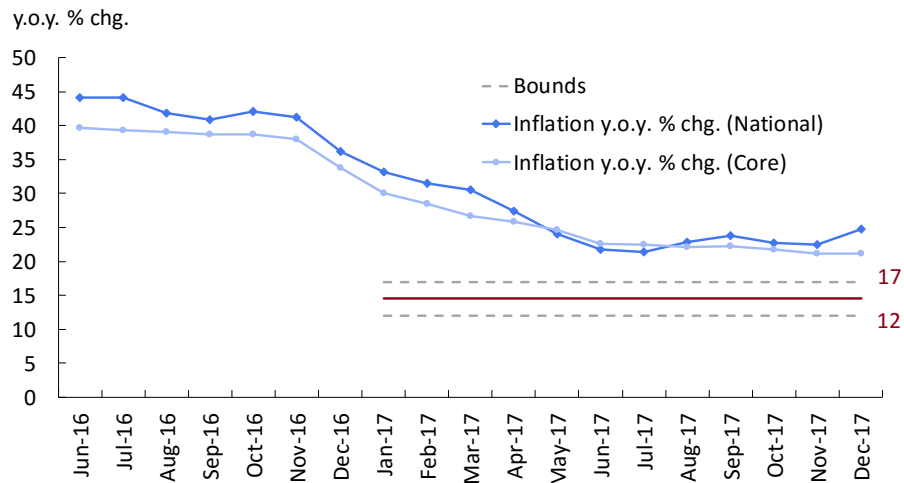
Considering the deviation from inflation rates, besides increasing the contractive bias of monetary policy, a deferral of the 5 percent target was announced, setting a new target of 15 percent for this year, 10 percent for 2019, and 5 percent starting in 2020. In this context, the BCRA decided in early January to lower its policy rate by 75 percentage points, in order to bring it to an annual rate of 28 percent, while LEBAC rates also adjusted to the new inflation target path, with a decrease in the secondary market of between 2 and 3 percentage points (depending on their maturity), from the high levels recorded in late December of last year. Together with the deferral of the target, the path for BCRA transfers to the National Treasury was announced, which will allow a better foresee of the monetary policy.

This year's starting point for the inflationary dynamics appears more favorable than that of early 2017: there is a greater initial contractive bias in monetary policy; a lower expected increase in regulated prices; and less persistence in inflation. Still, in the next few months, the BCRA will be cautious when adjusting the monetary policy to the new disinflation path.

5.1 Monetary policy in 2017: accountability

Inflation in December, 2017, rose to a year-on-year rate of 24.8 percent, above the target set for the year (14.5 ± 2.5 percent) (see Figure 5.1). This deviation was accounted for by a combination of several factors: a) a monetary policy which was loosened in the last part of 2016 and the first part of 2017, when the BCRA lowered its interest rate, facing the favorable evolution inflation had shown in the last months of 2016; b) a higher-than-expected persistence of inflation in nominal contracts; c) a higher-than-expected increase in regulated prices.

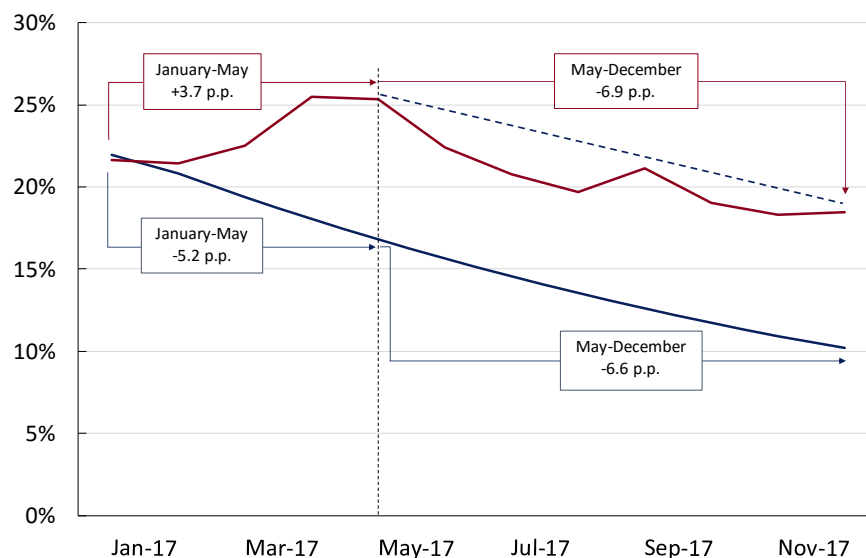
Figure 5.1 | Inflation and 2017 targets



Note: CPI series correspond to CPI of national coverage from dec-16, linked with the Greater Buenos Aires CPI up to apr-16 and backward with the CPI National weighted (weighted average by expenditure of the the CPIs of the City of Buenos Aires, Córdoba and San Luis). Three series were used for the construction of core inflation: National CPI core inflation since January 2017, GBA CPI core inflation from May 2016 to December 16, and Ciudad Autónoma de Buenos Aires CPI core inflation before May 2016. Source: BCRA, INDEC and provinces statistics offices

The very favorable performance of inflation in the second half of 2016 had led the Central Bank to excessively loosen its policy monetary policy bias. This change in monetary policy led to a price dynamics in the first half of 2017 which fell outside of the path sought by the monetary authority (see Figure 5.2). Against that, starting in April, the BCRA increased the contractive bias of monetary policy, increasing the policy rate three times and showing an active operation in the LEBAC secondary market in order to raise these instruments' interest rates (see Figure 5.3). Thus, while in the first few months of 2017 core inflation deviated from the desired path, since the change in monetary policy, the decreasing pace of inflation nearly approached the inflationary target (see Figure 5.2).

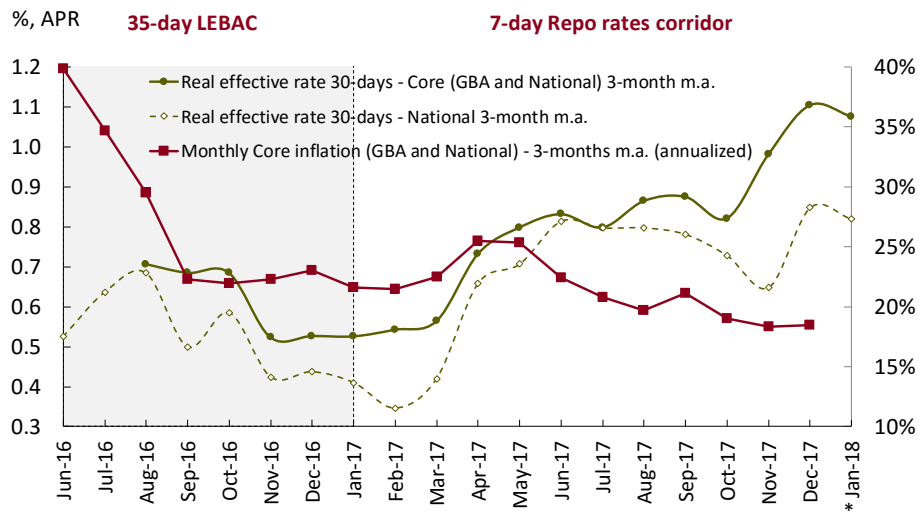
Figure 5.2 | Disinflation path – Core CPI
(Core inflation; m.o.m. % chg.)



Source: BCRA from INDEC data

The result of these decisions became apparent in the second half of 2017, when the three-month moving average of core inflation pierced the monthly 1.7 percent rate seen until then³⁸. This indicator showed a significant decrease and closed the year in a monthly 1.4 percent rate (an annualized rate of 18.5 percent), the lowest value in the last six years (see Figure 5.3). Headline inflation, in turn, fell 11.8 percentage points in December relative to the year-on-year change seen a year before, while inflation expectations remained anchored throughout the last year, with a clear decreasing trend for the next few years (see Figure 5.4).

Figure 5.3 | Monetary policy bias and inflation

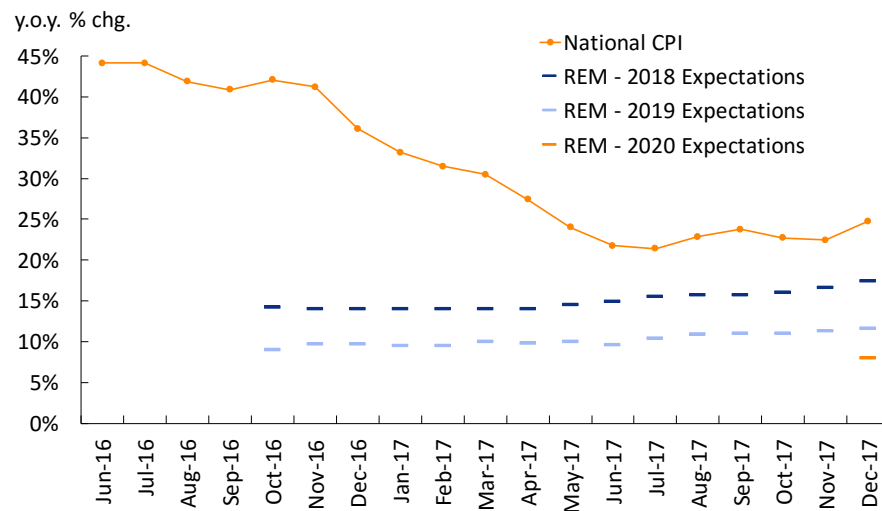


Note: real rate estimated using REM's 3 month average inflation expectations and the monetary policy rate corresponding to the period. Three series were used for the construction of core inflation: National CPI core inflation since January 2017, GBA CPI core inflation from May 2016 to December 16, and Ciudad Autónoma de Buenos Aires CPI core inflation before May 2016.
Source: BCRA, INDEC and Ciudad Autónoma de Buenos Aires' Statistics Office.

However, the persistence of inflation in nominal contracts (such as wage agreements) was greater than expected. Many nominal contracts were negotiated in 2017 with increases significantly lower than the annual 2016 inflation, which proves that the inflation targeting scheme managed to anchor inflation expectations. These increases, however, were not consistent with the inflation target. Given this persistency mechanisms, monetary policy was not as contractive as it should have been to achieve the inflation goal.

Finally, and to a lesser degree, a larger-than-expected increase in regulated prices was another reason behind the deviation from the target. The Market Expectation Survey expected for regulated price inflation in December, 2016, to be an annual 29.5 percent, but it was 38.7 percent. This factor contributed an annual 1.9 percent incidence in addition to expectations. Within this group, larger-than-expected increases include fuel (0.6 percent), prepaid medical services (0.4 percent) and education (0.3 percent). This category also includes utility bill increases (power, gas, water, and transportation) which moved above expectations, and had a direct effect on the costs of companies and an impact on other categories' prices.

³⁸ An indicator the BCRA follows closely to identify price dynamics is the core-inflation three-month moving average. Core inflation is computed in order to reduce the impact of regulated prices, which are not affected by monetary policy and are particularly significant in a period of reversion of outdated utility fees, and the three-month average is computed to reduce the volatility inherent to all monthly price indicators.

Figure 5.4 | CPI inflation and inflation expectations 2018-2020

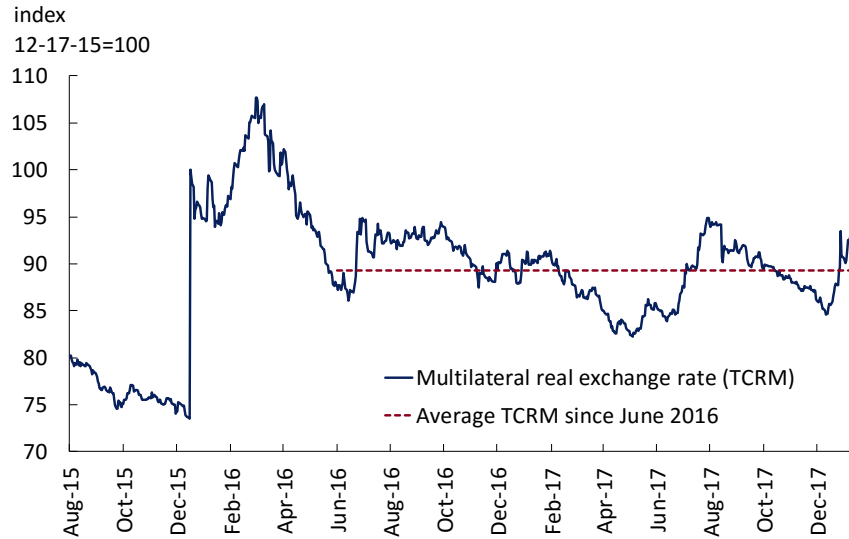
Note: CPI series correspond to CPI of national coverage from dec-16, linked with the Greater Buenos Aires CPI up to apr-16 and backward with the CPI National weighted (weighted average by expenditure of the the CPIs of the City of Buenos Aires, Córdoba and San Luis).
Source: BCRA, INDEC and provinces statistics offices

Unlike other disinflation processes seen in the country, this time around, the fall in inflation is being achieved without creating outdated utility fees and with free prices and exchange rate. Moreover, last year's fall in inflation was achieved in a context of positive economy performance: credit expanded markedly in real terms, and the growth in economic activity could approach 3 percent in 2017, without signs of decelerations, both in the contemporary indicator of the BCRA (which shows a seasonally-adjusted rate of growth of 0.94 percent for the last quarter of last year), and in the leading index computed by the BCRA (which does not foresee a change in the current expansionary phase) (see Section 3.1).

The flexible exchange rate regime, which is the norm in countries with inflation targets, has made it possible for disinflation to evolve without a sustained real appreciation of the peso. In fact, the multilateral real exchange rate hovers since mid-2016 around a level 21.5 percent above the one it had before the late-2015 unification of the exchange market (see Figure 5.5). This dynamics is different from the systematic real domestic currency appreciation episodes typical in stabilization programs based on a fixed exchange rate. Having a floating exchange rate makes it possible for the economy to better absorb external shocks and contributes to the prevention of a build-up of macroeconomic unbalances³⁹.

³⁹ See October, 2017, Monetary Policy Report, Exhibit 1 / Floating exchange rate and current account volatility.

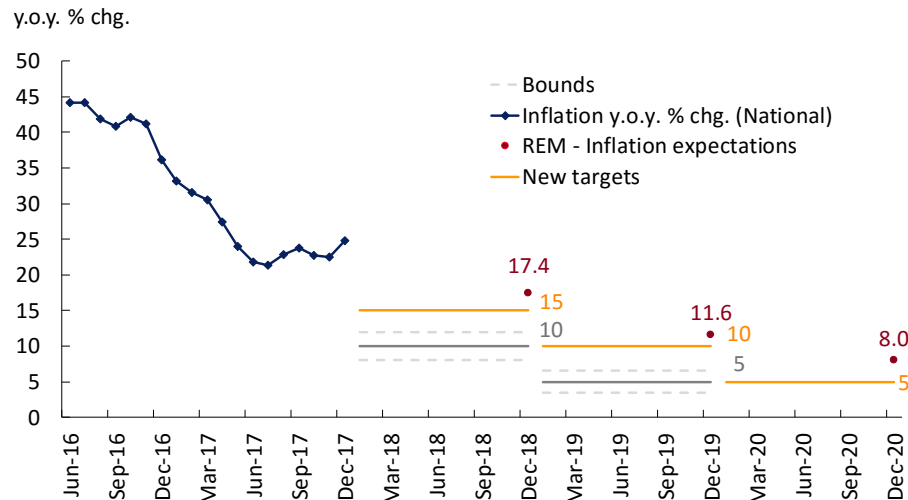
Figure 5.5 | Real effective exchange rate



Source: INDEC, Ciudad Autónoma de Buenos Aires' Statistics Office and San Luis' Statistics Office, Datastream and REM BCRA.

Facing the deviation from inflation targets seen last year, besides the increase in the contractive bias of the monetary policy, a deferral was announced of the 5 percent target regarding the original path announced; defining new targets of 15 percent for this year, 10 percent for 2019 and 5 percent starting in 2020. The new targets are consistent with the declining trend of inflation expectations and remain below the inflation rates foreseen by the market, which according to December's Market Expectation Survey, are of 17.4 percent for 2018, 11.8 percent for 2019, and 8 percent for 2020 (see Figure 5.6).

Figure 5.6 | Inflation, targets and expectations 2018-2020



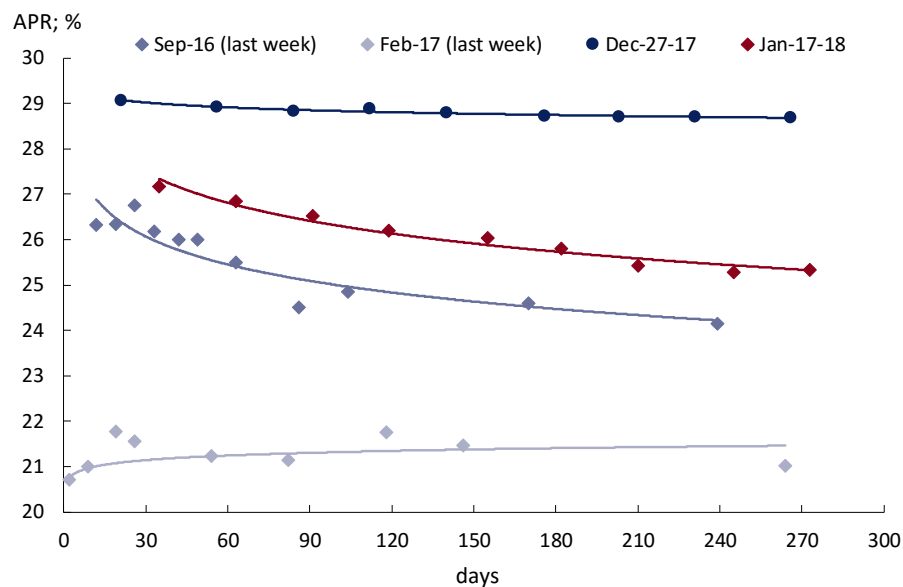
Note: CPI series correspond to CPI of national coverage from dec-16, linked with the Greater Buenos Aires CPI up to apr-16 and backward with the CPI National weighted (weighted average by expenditure of the the CPIs of the City of Buenos Aires, Córdoba and San Luis).

Source: INDEC, Statistical Office of the City of Buenos Aires and Market Expectations Survey (REM-BCRA) as for Sep-17

Interest rates recorded until the deferral of the target were consistent with the goal of reaching an inflation rate of 10 percent (± 2 percent) during the year. At the same time, according to the BCRA, the disinflation process is on track as of the last semester: core inflation in the last three months hovers around 18 percent in annualized terms. Moreover, the impact of the December increase of regulated prices on core inflation has been moderate, and is interpreted as a temporary phenomenon on the inflation rate.

In this context, on January 9th, the BCRA decided to reduce its policy rate by 75 percentage points, in order to bring it to an annual 28 percent. Meanwhile, LEBAC rates also converged around the new path of target inflation, showing a decrease of between 2 percentage points and 3 percentage points in the secondary market, depending on maturities, relative to the maximum levels seen in late December (see Figure 5.7). Based on the favorable evolution of core inflation and the deferral of the inflation target, this decrease in the reference rate keeps the real interest rate (and, by extension, the contractive bias of the monetary policy) from increasing.

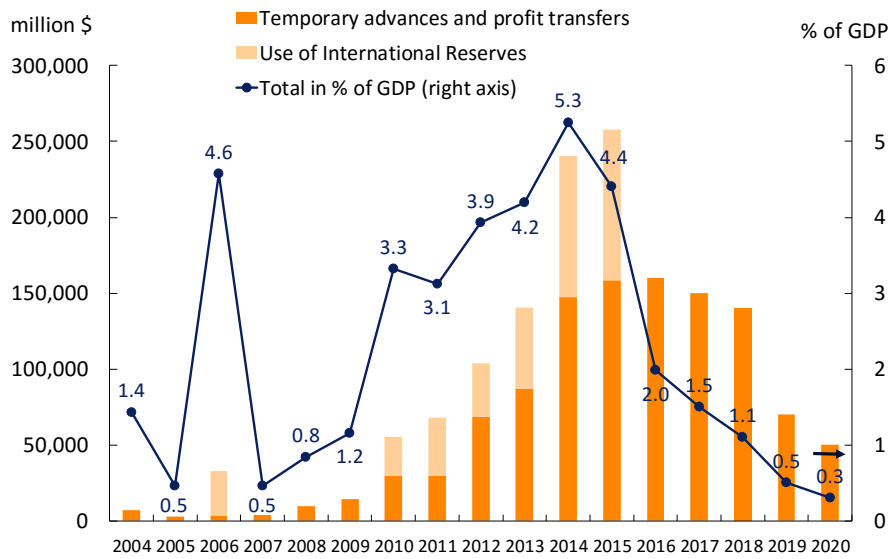
Figure 5.7 | LEBAC yield curve, secondary market



Source: BCRA

Besides deferring the target, clarification was provided as regards the path of transfers from the BCRA to the National Treasury, so as to make the management of monetary policy more predictable. The National Public Sector Budget included for this year a transfer of funds of \$140 billion or 1.1 percent of GDP, which represents a 0.4 percent of GDP decrease relative to 2016 (see Figure 5.8). In line with the gradual correction envisioned for the fiscal deficit, a scheme was established to reduce transfers to \$70 billion (or 0.5 percent of GDP) in 2019 and, starting in 2020, to a level linked with the increase in money demand associated with the real growth of the economy. Assuming a monetary base stock of 10 percent of GDP and a 3 percent economic growth for 2020, the transfer of funds to the Treasury would total 0.3 percent of the GDP. Thus, given the interest rate and the money demand, a decreasing trend in these transfers would imply a lower level of central bank non-monetary liability issuance for a single path of currency purchases (see Exhibit 5 / LEBAC sustainability, where an analysis of the impact of this path of transfers on the BCRA's balance sheet is presented).

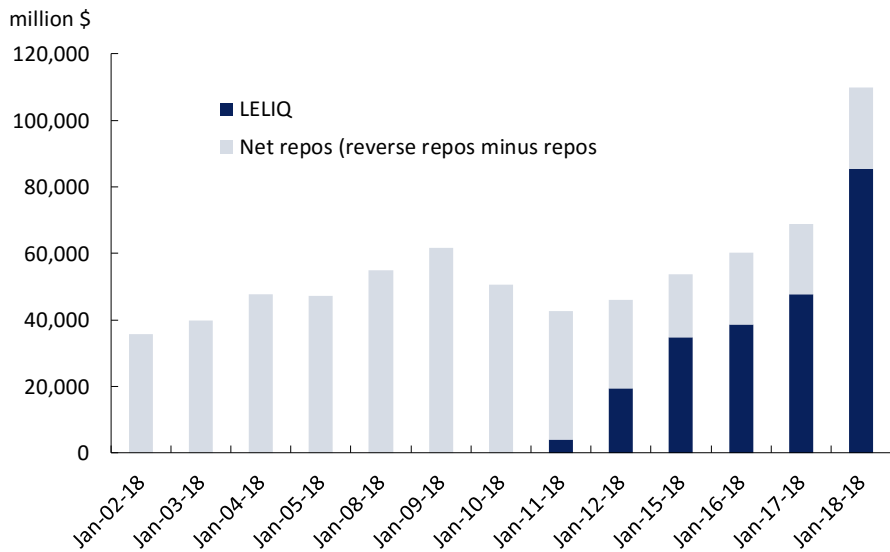
Figure 5.8 | Central Bank's transfers to National Treasury



Source: BCRA and INDEC

In early 2018, the BCRA implemented the Liquidity Bills (LELIQ)⁴⁰. These are peso-denominated instruments with seven-day maturity. The monetary authority offers LELIQ daily for financial institutions' own portfolios only. Moreover, they can be traded in the secondary market only between financial institutions, and can also be used as collateral in repo operations. The goal of these new regulation instruments is to polish the implementation of monetary policy through an improvement of the repo market. Banks are provided with a security which can be traded in the secondary market –which provides more liquidity to the interbank market for funds with maturities of up to seven days–, and whose interest rate is linked to the policy rates corridor. Since their implementation, these instruments have increased their share over repos in the holdings of financial institutions (see Figure 5.9).

Figure 5.9 | Liquidity letters and net repos



Source: BCRA

⁴⁰ See Communication "A" 6426, January 10th, 2018.

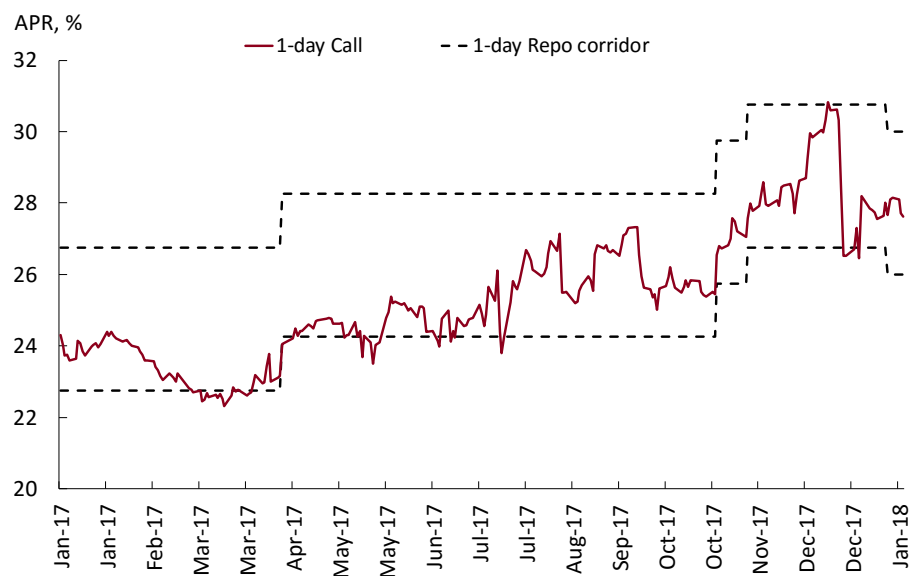
This year's starting point for the inflationary dynamics looks more favorable than last year's (see Figure 4.12). First, core inflation, measured as a three-month average, was in last December below the level of the same period of 2016 (18.5 percent versus 23.1 percent); in turn, December's year-on-year headline inflation was 24.8 percent (compared to 36.6 percent a year before), which is favorable, given the persistence still seen in contracts. Moreover, the increase in regulated prices projected for this year should be substantially lower than last year's (21.8 percent versus 38.7 percent). Finally, the monetary policy bias at the end of 2017, measured by the real interest rate of the monetary policy, is more contractive than the one at late 2016 (an annual 10.5 percent versus 3.9 percent). Still, in the coming months, the BCRA will be cautious when adapting the monetary policy to the new disinflation path.

5.2 Increase in the monetary policy's contractive bias in 2017

The inflation targeting scheme requires an explanation both for the deviation and for the measures implemented in order to bring inflation back to a path consistent with the target. The following are the main measures taken to increase the contractive bias of monetary policy by the BCRA during 2017, starting at the time in which it noticed the inflation dynamics was deviating from the target.

The increase in monthly headline inflation and the persistence of core inflation in the first few months of last year led the BCRA to increase the policy rate (the center of the 7-day repo band) by 150 basis points in April, 150 basis points in October, and 100 basis points in November (see Figure 5.10). Thus, the policy rate went from an annual rate of 24.75 percent in March to an annual rate of 28.75 percent in December, which took the real policy rate from an annual 5 percent to an annual rate of about 10 percent in that period (see Figure 5.3).⁴¹

Figure 5.10 | Overnight Repo rate corridor and call rates (1 day)

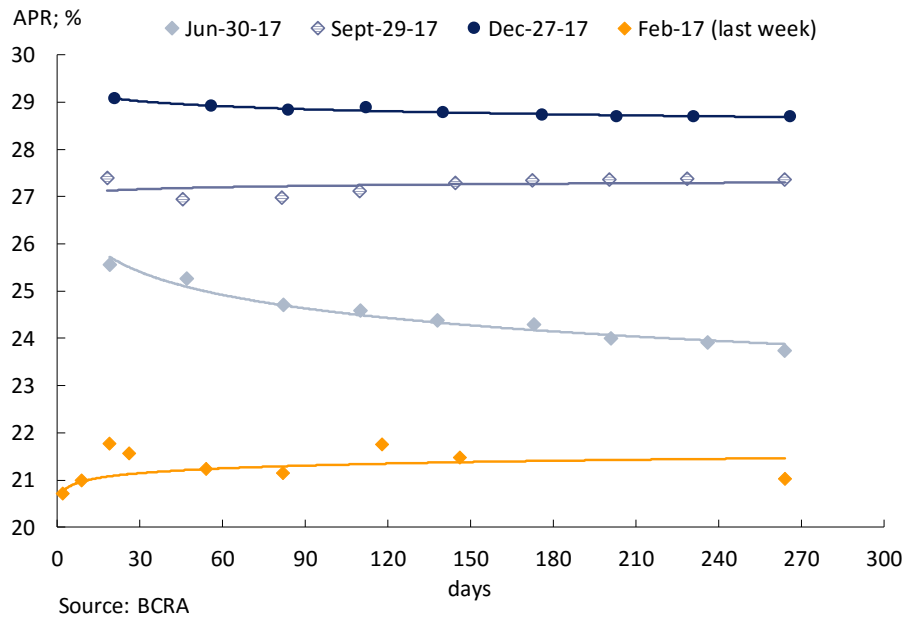


Source: BCRA

⁴¹ The real interest rate was computed with the three month average of monthly headline inflation projected in the Market Expectations Survey carried out by the BCRA. The use of the three-month average makes it possible to smooth out temporary impacts on the inflation rate.

As a supplement to the management of the policy rate, the BCRA modified throughout last year the liquidity conditions in the LEBAC secondary market through open market operations, with the goal of reinforcing the pass-through of its policy rate to the rest of the interest rates in the economy. The monetary authority sold securities for NV \$ 1,127,829 million in 2017, which accounted for 20 percent of all operations in the LEBAC secondary market. Thus, the yield curve for BCRA securities increased over the year, approximately 7.5 percentage points between late-February and December 27th, 2017 (see Figure 5.11).

Figure 5.11 | LEBAC yield curve, secondary market.

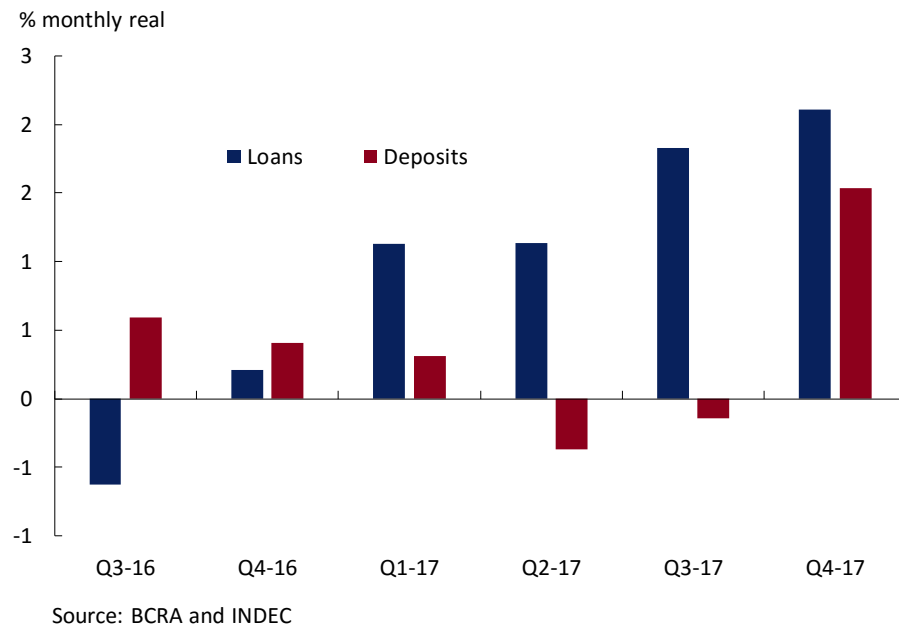


Money market interest rates followed the increase in the monetary policy and LEBAC rate, and remained constrained within the repo band (mainly beginning in July). We should remember that the reverse repo rate acts as a lower bound for the interbank market interest rates: when the market rate is pushed below that point, agents can place their excess funds through reverse repo with the BCRA. Meanwhile, the repo rate works as an upper bound: when the market rate is pressured to move above that level, agents can cover their fund shortage with BCRA loans through repos. Thus, both the third-party repo rate and the interbank 1-day call rate increased approximately 6 percentage points between March and December, and closed the year at a monthly average annual rate of 27.7 percent and 28.8 percent, respectively (see Figure 5.10).

5.3 Credit expansion put pressure on bank liquidity and passive interest rates, reinforcing the transmission mechanism of the policy rate

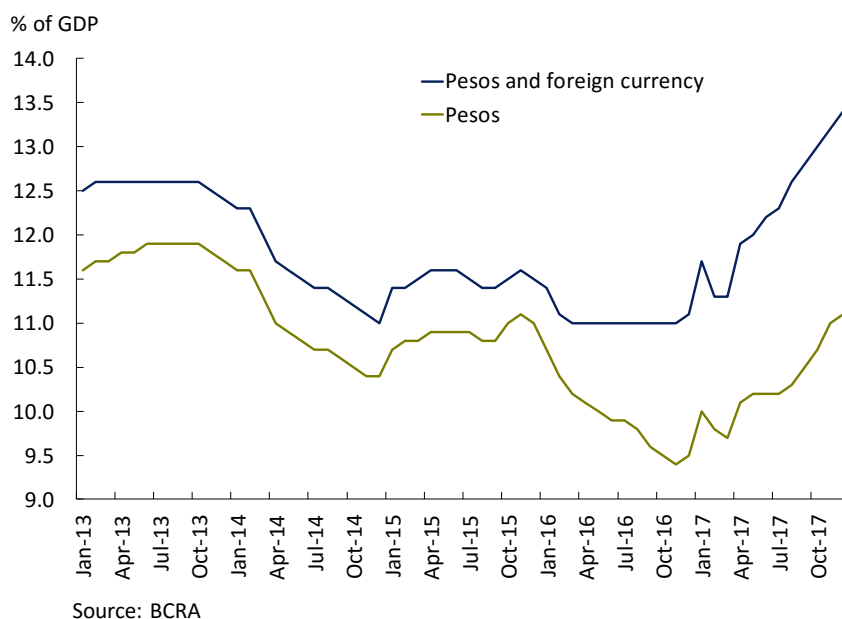
Private-sector peso-denominated deposits grew at a real seasonally-adjusted monthly rate of 0.3 percent during 2017, accumulating a 4 percent year-on-year expansion as of December. Demand deposits (current and savings accounts) performed better, with a seasonally-adjusted 0.7 percent monthly increase in real terms, relative to fixed-term deposits, which were virtually stagnant over the year. The last quarter of the year showed more dynamic deposits, with a monthly seasonally-adjusted real increase of 1.5 percent, mainly driven by fixed-term deposits, which grew at a 2.0 percent monthly rate, while demand deposits increased a monthly 1.1 percent (see Figure 5.12).

Figure 5.12 | Private sector loans and deposits growth in pesos
(seasonally adjusted)



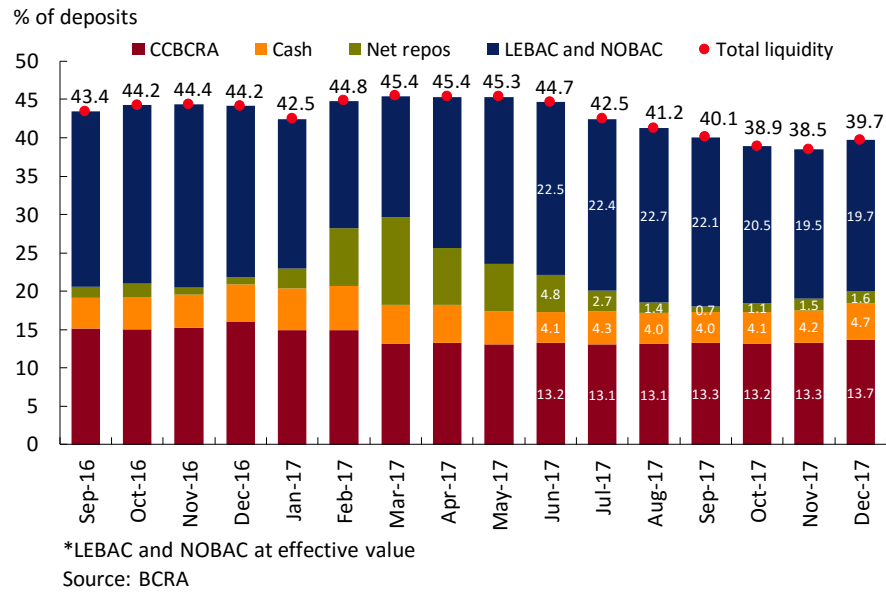
Loans, in turn, expanded faster than deposits (see Figure 5.12). Thus, peso-denominated loans to the private sector increased at a real monthly rate of 1.6 percent, seasonally adjusted, during the year, reaching a real annual year-on-year expansion of 20.3 percent in December (a real year-on-year increase of 24.3 percent, if foreign currency loans are also considered). While there were increases in most lines, the greatest were seen in mortgage credit, led by UVA-denominated loans—with a share of 92 percent of outlays in the case of individuals in December—, pledge loans, personal loans, and through documents. In spite of that dynamics, the stock of loans to the private sector remains depressed both in historical terms and relative to other emerging economies (11.1 percent of GDP for peso-denominated financing and 13.4 of GDP if foreign currency loans are also considered), and thus has room to grow (see Figure 5.13).

Figure 5.13 | Financial system loans to private sector



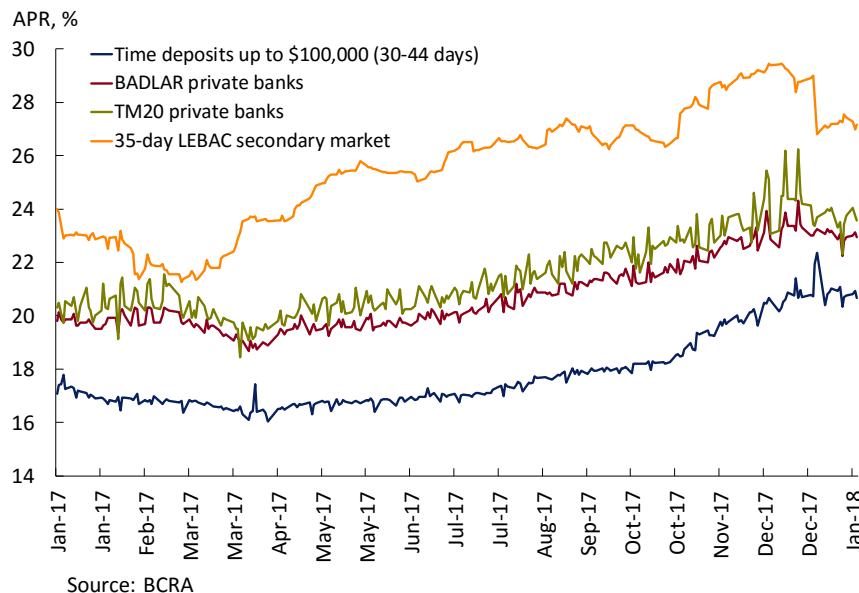
In a context in which credit to the private sector grew faster than deposits, the liquidity of financial institutions in the domestic currency segment fell. Total liquidity, which includes cash in banks, current account deposits in the central bank, LEBAC and net repos, fell from 45.4 percent of deposits in March to 39.7% in December, while excess liquidity (taking only LEBAC and net repos) went from 27.2 percent of deposits to 21.3 percent in the same period (see Figure 5.14). This contributed to the strengthening of the transmission mechanism of the policy rate to the financial system’s passive interest rates.

Figure 5.14 | Banking liquidity ratio



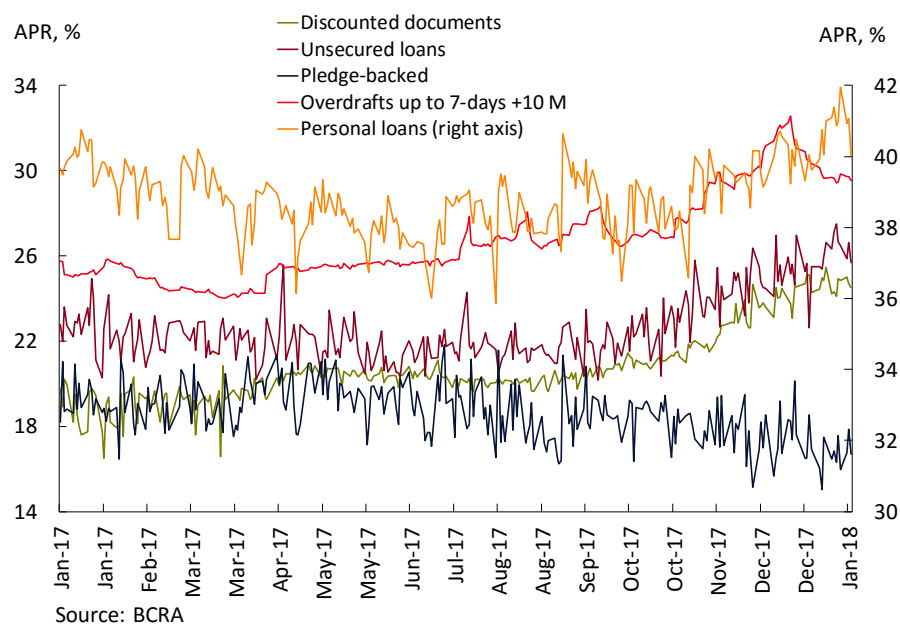
In consequence, deposit interest rates began to increase starting in April, slowly at first, and then with ever-greater rises as the year progressed. The BADLAR rate of private banks increased 3.7 percentage points since March and reached a monthly average of 23.2 percent in December, whereas in the retail segment, the increase in the interest rate of fixed-term deposits was of 4.2 percentage points in the same period, closing December with a 20.8 percent monthly average (see Figure 5.15). The interest rates of UVA-adjusted deposits increased last year as well, with an average increase of 4 percentage points —focused on the second half of the year—, reaching a monthly average of an annual 5 percent in the last month of the last year.

Figure 5.15 | Banking deposits interest rates and LEBAC interest rates



Active interest rates showed a mixed behavior throughout the year. Interest rates for corporate financing increased similarly to those of fixed-term deposits, even though the increases were mainly focused on the last quarter of the year. Thus, average monthly interest rates of current account advances, unsecured loans, and discounted bills increased 4.4 percentage points, 3.1 percentage points and 5 percentage points between March and December, respectively (closing December with annual rates of 34.1 percent, 25.4 percent and 24.2 percent, respectively). Household consumer loans increased less: the cost of financing of personal loans increased 1 percentage point in the same period (almost an annual 40 percent in December), whereas credit card rates remained virtually stable (an annual 42.2 percent in December). Lastly, the cost of loans secured by a pledge fell 1.3 percentage points between March and December, and reached an annual 17.4 percent at the end of last year (see Figure 5.16). The rates of UVA-adjusted loans also showed heterogeneous behaviors: the cost of mortgage and loans secured by a pledge remained virtually unchanged between March and December (closing the year near an annual 5 percent and annual 10 percent, respectively), and increasing 1.7 percentage points in the same period in the case of personal loans, reaching an annual 10 percent in the last month of 2017.

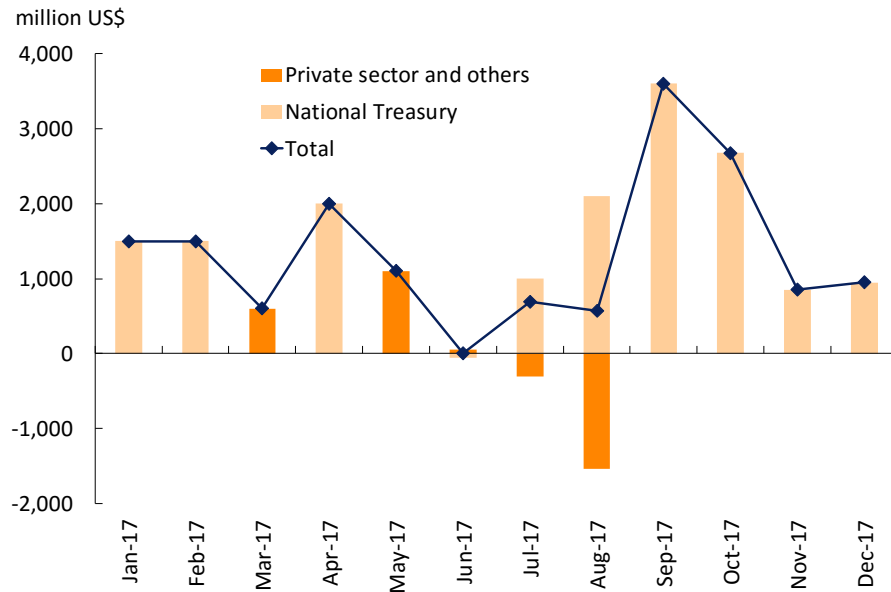
Figure 5.16 | Banking credit interest rates



5.4 The BCRA continued to build up its international reserves

In 2017, the BCRA continued to accumulate foreign currency in order to reach a level of international reserves similar to that of other countries in the region which also use inflation targets and a floating exchange rate. On April 18th, 2017, the monetary authority announced its intention of increase the ratio of international reserves to 15 percent of GDP. This target is secondary to that of achieving a low and stable inflation, and lacks a defined compliance schedule. This strategy is based on a preventive demand for foreign currency which is not aimed at fixing their level but at avoiding disruptive volatility in the exchange rate. Having an adequate stock of international reserves is part of the BCRA's macroprudential approach, and contributes to the prevention of the negative effects on the economy of changes in international liquidity conditions.

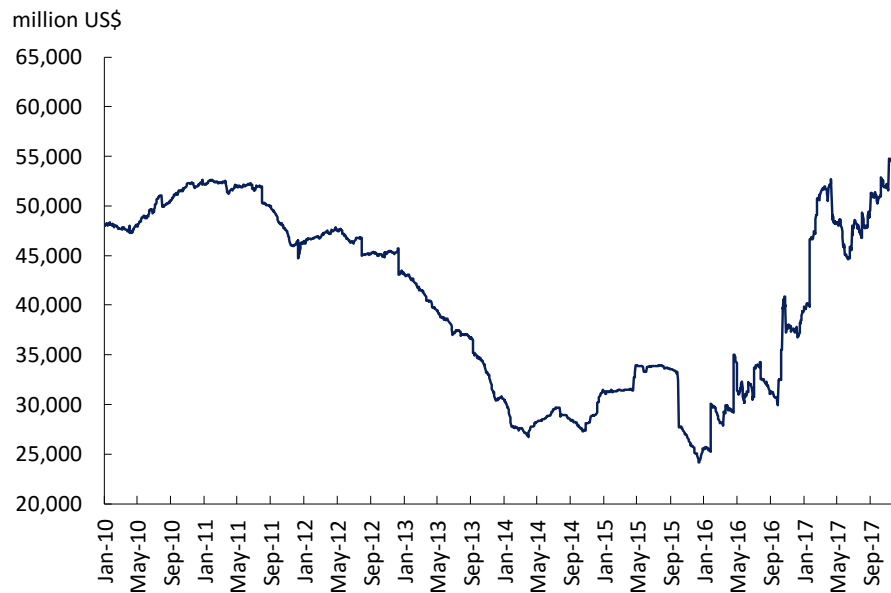
Figure 5.17 | BCRA's international reserves purchases



Source: BCRA

Over the year, foreign currency held by the Central Bank increased USD 15.747 billion, mainly through direct purchases to the National Treasury, reaching a level of USD 55.055 billion in late December (9.1% of the GDP), and accumulating an increase of USD 29.440 billion since late November, 2015 (see Figures 5.17 and 5.18) (see Exhibit 5 / The sustainability of LEBAC, for an analysis of the impact of the international reserve build up on the BCRA's balance sheet).

Figure 5.18 | BCRA's international reserves



Source: BCRA

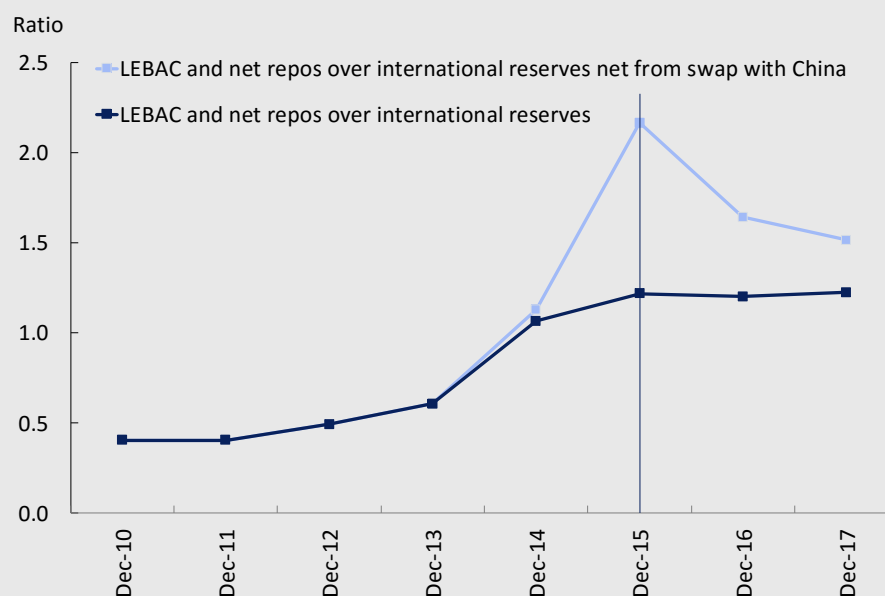
Exhibit 5 / LEBAC Sustainability

When studying the evolution of an institution's liabilities and their sustainability, it is critical to consider three fundamental variables: the evolution of assets, the evolution of income, and the institution's future income prospects.

In the last few years, the BCRA has acquired foreign currency with the goal of reaching a level of international reserves similar to that of other countries in the region using an inflation targeting regime and a floating exchange rate (see Section 5.4). The BCRA has supplemented these foreign asset purchases with sterilization operations, in order to prevent an excess of money supply which would drive the interest rate outside the range established to meet the inflation targeting. These sterilization operations include the sale of LEBAC by the BCRA or reverse repurchase operations by financial institutions, both aimed at absorbing the monetary base. As a result, external assets have increased along with the BCRA non-monetary liabilities (LEBAC and net repos).

The relationship between LEBAC plus net repos and international reserves remained virtually stable since late 2015, after a significant increase between 2011 and 2015, as a consequence of the fall in reserves. When discounting the swap with China from international reserves, it is possible to see that the increase recorded between 2011 and 2015 is more pronounced, and that 2015's stability is actually a significant fall in LEBAC plus net repos relative to external assets (see Figure 1).

Figure 1 | LEBAC and net repos over international reserves.
(Average December)

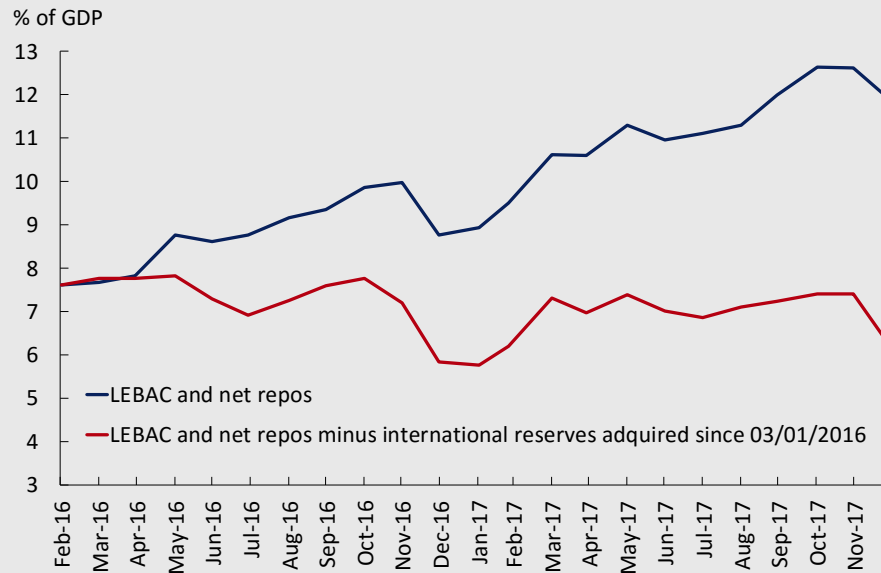


Source: BCRA

After considering the evolution of assets in the analysis, the evolution of the GDP is included. Using ratios in terms of GDP is the usual way of analyzing the evolution of macroeconomic variables over time, so as to discount the evolution accompanying the growth of the real economy and inflation. It also makes sense because the BCRA's income is associated to both variables.

The stock of non-monetary liabilities, after discounting the reserves acquired since March, 2016⁴², falls from 7.2 percent of the GDP in March, 2016, to 6.2 percent of GDP in late 2017 (see Figure 2). While it is true that this stock grows if acquired reserves are not discounted, it has been seen that the appropriate thing to do is to analyze the evolution of both the liabilities and assets it creates.

Figure 2 | LEBAC and net repos minus international reserves



Source: BCRA and INDEC

Finally, it is necessary to analyze the BCRA’s future income, which represent an economic asset not recorded in the balance sheet. The BCRA receives income, known as seigniorage, for the issuance of a liability (monetary base) which does not bear interest (and has a low issuance marginal cost), but is demanded by economic agents who use it as a means of payment and as a store of value⁴³. When making transfers to the National Treasury, the monetary authority shares a part of that seigniorage. Through a series of assumptions about the evolution of the economy, an estimation is made of future seigniorage income. Based on the agreement with the Treasury about those transfers (see Figure 5.8), it is possible to assess the share of that income that will remain in the BCRA and what its impact on its economic balance sheet will be.

Considering a scenario in which the economy grows at an annual 3 percent rate, with a 5 percent annual rate of inflation, and with a stable monetary base at 9,8 percent of the GDP (last December’s level), the BCRA will achieve an annual seigniorage income of 0.74 percent of GDP. If we deduct from that flow the transfers to the Treasury of 0.3 percent of GDP (as per the agreement), and the overhead and printing costs of the BCRA of 0.08 percent of GDP, and if we classify this net income as a perpetual income, the net

⁴² This does not include total international reserves, but only those acquired since March, 2016, as the focus is on the result of the instrumentation of the monetary policy with interest rates, floating exchange rate, and occasional sterilized operations applied since then.

⁴³ This income can be broken down in two factors: 1) the public’s desire to modify its demand for money (real balances), which depends on interest rates and the level of economic activity; and 2) the inflation tax, that is, the loss of purchasing power due to keeping hold of money, caused by inflation, which represents a transfer of resources from the public to the State. While the inflation tax is not desirable from a distributional point of view, the inflation targeting rate as of 2020 is at the level shown by the economies in the region and other emerging economies, and is associated to the achievement of price stability.

present value of net seigniorage is 37 percent of GDP⁴⁴. In this scenario, this source of funds equals three times the level of non-monetary liabilities currently held by the monetary authority: approximately 12 percent of the GDP. Even if assets do not include those illiquid instruments, such as non-transferable bills and the stock of transitory advances to the Treasury, the economic net equity is at high levels, at 34.7 percent of GDP (see the following table, which compares the balance sheet at end-2017 to the “economic” balance sheet, which considers the present value of seigniorage in assets).

Table I | Comparison between "accounting" balance at the end of 2017 and "economic" balance

"Accounting"				"Economic"			
Assets		Liabilities and equity		Assets		Liabilities and equity	
International reserves	10.1%	Monetary base	9.8%	International reserves	10.1%	Monetary base	9.8%
Non-transferable letters	9.0%	Liabilities in dollars	4.4%	Non-transferable letters	0.0%	Liabilities in dollars	4.4%
Public bonds in dollars	3.3%	LEBAC + net repos	11.9%	Public bonds in dollars	3.3%	LEBAC + net repos	11.9%
Public bonds in pesos	0.6%			Public bonds in pesos	0.6%		
Transitory overdrafts and other net assets in pesos	4.7%			Transitory overdrafts and other net assets in pesos	0.0%		
				Net Seigniorage	46.8%		
		Equity	1.5%			"Economic" equity	34.7%

Fuente: BCRA

In sum, if we consider the acquisition of foreign assets financed through monetary liabilities, the evolution of GDP and the projection of future BCRA income, we see that the non-monetary liabilities net of acquired reserves have fallen as a share of GDP, and that, even without discounting these foreign assets, future income are more than ample to accommodate them.

⁴⁴ The present value of seigniorage with the variables in long-term values can be expressed as follows:

$$PVS = \frac{\Delta MB}{GDP} \left(\frac{1+g}{r-g} \right)$$

where $\frac{\Delta MB_t}{GDP_t} = \frac{(MB_t - MB_{t-1})}{GDP_t}$ is the annual seigniorage in terms of the GDP (0.74 percent of GDP for all periods, less 0.3 percent of GDP of transfers, less 0.08 percent of primary expenditures of the BCRA), r is the real interest rate (4 percent), and g is the growth rate of the economy (3 percent). The present value of seigniorage can also be expressed considering the present value of interest not paid due to using a monetary liability less the initial stock of the monetary base:

$$PVS = i \frac{mb}{(1+i)} \left(\frac{1+r}{r-g} \right) - mb$$

In this case, the result would be 86.0 percent (the present value of interest not paid on the monetary base), less the present value of transfers and primary expenditures in terms of the GDP (30.9 percent and 8.2 percent, respectively), which yields 46.8 percent of GDP. If we deduct from this value the 9.8 percent of GDP of the stock of the monetary base, we arrive at the 37 percent of GDP obtained with the above formula. This is the way in which seigniorage is expressed in the economic balance of Table I. For a detailed analysis of the computation of Government seigniorage, see Buiter, W. (2007): "Seigniorage", NBER, Working Paper No. 12919.

Abbreviations and Acronyms

€: Euro

AFCP: *Asociación de Fabricantes de Cemento Portland*

AFIP: *Administración Federal de Ingresos Públicos.* Federal Administration of Public Revenues

APR: Annual percentage rate

AUH: *Asignación Universal por Hijo.* Universal Child Allowance

Avg.: Average

BADLAR: Buenos Aires Deposits of Large Amount Rate (Interest rates for deposits over 1 million pesos for terms of 30-to-35 days)

BCBA: *Bolsa de Comercio de Buenos Aires.* Buenos Aires Exchange

BCRA: *Banco Central de la República Argentina.* Central Bank of Argentina

b.p.: basis points

CABA: *Ciudad Autónoma de Buenos Aires.* Autonomous City of Buenos Aires

Bontes: *Bonos del Tesoro.* National Treasury bonds

CEMBI+: Corporate Emerging Market Bond Index Plus

CEMBI+AR: Corporate Emerging Market Bond Index Plus Argentina

CER: *Coeficiente de Estabilización de Referencia.* Reference Stabilization Coefficient

Chg.: Change

CNV: *Comisión Nacional de Valores.* National Securities Commission

CSJN: *Corte Suprema de Justicia de la Nación.* National Supreme Court of Justice

DJVE: *Declaraciones Juradas de Ventas al Exterior.* Export Sales Affidavit

ECB: *Banco Central Europeo.* European Central Bank

ECLAC: Economic Commission for Latin America and the Caribbean

EDP: *Equipo Durable de Producción.* Production durable equipment

EMAE: *Estimador Mensual de la Actividad Económica.* Monthly Economic Activity Indicator

EMBI+: Emerging Markets Bond Index Plus

EMBI+AR: Emerging Markets Bond Index Plus Argentina

EMBIG: Emerging Market Bond Index Global

EPH: *Encuesta Permanente de Hogares.* Permanent household survey

f: Forecast

Fed: United States Federal Reserve

FIEL: *Fundación de Investigaciones Económicas Latinoamericanas*

FOB: Free on Board

FOMC: *Comité Federal de Mercado Abierto.* Federal Open Market Committee

GBA: *Gran Buenos Aires.* Greater Buenos Aires

GDP: Gross domestic product

IAMC: *Instituto Argentino de Mercado de Capitales*

IBIF: *Inversión Bruta Interna Fija.* Gross domestic fixed investment

ICC: *Índice de Confianza del Consumidor elaborado por la Universidad Torcuato Di Tella.* Consumer Confidence Index computed by the Torcuato Di Tella University

ICC-INDEC: *Índice del Costo de la Construcción.* Construction Cost Index

IGA-OJF: *Índice General de Actividad de Orlando J. Ferreres.* General Activity Index released by Orlando J. Ferreres

ILA: *Índice Líder de la Actividad.* Leading Activity Index

IMF: International Monetary Fund

INDEC: *Instituto Nacional de Estadística y Censos.* National Institute of Statistics and Censuses

INML: *Índice de Novillos del Mercado de Liniers*

IPC CABA: *Índice de Precios al Consumidor de la Ciudad de Buenos Aires.* Consumer price index for the City of Buenos Aires

IPC GBA: *Índice de Precios al Consumidor del Gran Buenos Aires.* Greater Buenos Aires Consumer price index

IPC-NP: *Indicador Nacional Ponderado.* Weighted national consumer price index

IPC San Luis: *Índice de Precios al Consumidor de la Provincia de San Luis.* Consumer price index for the Province of San Luis

IPIB: *Índice de Precios Internos Básicos.* Basic industrial price index

IPIM: *Índice de Precios Internos al Por Mayor.* Domestic wholesale price index

IPMP: *Índice de Precios de las Materias Primas.* Commodity price index

IPOM: *Informe de Política Monetaria.* Monetary Policy Report

ITCRM: <i>Índice de Tipo de Cambio Real Multilateral</i> . Real Multilateral Exchange Rate Index	PMI: Purchasing Managers' Index
LAC: Latin American Consensus Forecasts	PP: <i>Productos primarios</i> . Primary products
LEBAC: <i>Letras del Banco Central</i> . BCRA bills	R\$: Brazilian Real
LELIQ: Central Bank Liquidity bills	REM: <i>Relevamiento de Expectativas de Mercado</i> . Market Expectations Survey
LFPIF: <i>Línea de financiamiento para la producción y la inclusión financiera</i>	REPO: Repurchase Agreement
M2: <i>Billetes y monedas + cuasimonedas en circulación + cuentas corrientes en \$ y cajas de ahorro en \$</i> . Notes and coins + quasimonies + \$ savings and current accounts	ROE: <i>Registros de Operaciones de Exportación</i> . Export operations records
m.a.: moving average	Rueda REPO: Tasa de interés promedio de las operaciones a 1 día hábil entre entidades financieras en el mercado garantizado
MATBA: <i>Mercado a Término de Buenos Aires</i>	s.a.: Seasonally adjusted
MERVAL: <i>Mercado de Valores de Buenos Aires</i>	TFP: <i>Productividad total de los factores</i> . Total factor productivity
MIP: <i>Matriz insumo-producto</i> . Input-output matrix	TN: <i>Tesoro Nacional</i> . National Treasury
MOA: <i>Manufacturas de Origen Agropecuario</i> . Manufactures of agricultural origin	UCI: <i>Utilización de la capacidad instalada</i> . Installed capacity utilization
MOI: <i>Manufacturas de Origen Industrial</i> . Manufactures of industrial origin	US\$: United States Dollar
MSCI: Morgan Stanley Capital International Index	UTA: <i>Unión Tranviarios Automotores</i>
MTEySS: <i>Ministerio de Trabajo, Empleo y Seguridad Social</i> . Ministry of Labor, Employment and Social Security	UTDT: <i>Universidad Torcuato Di Tella</i> . Torcuato Di Tella University
MULC: <i>Mercado Único y Libre de Cambios</i> . Single free exchange market	UVA: <i>Unidad de Valor Adquisitivo</i> . Acquisition Value Unit
National IPC: <i>Índice de Precios al Consumidor Nacional</i> . National consumer price index	VAR: <i>Modelo de Vectores Autorregresivos</i> . Vector Autorregresive Models
NOBAC: <i>Notas del Banco Central</i> . BCRA notes	VAT: Value added tax
OPEC: Organization of the Petroleum Exporting Countries	VBP: <i>valor bruto de producción</i> . Gross production value
p.p.: Percentage points	y.o.y.: year-on-year
PCP-BCRA: <i>Predicción contemporánea del BCRA</i>	YPF SA: <i>Yacimientos Petrolíferos Fiscales Sociedad Anónima</i>