The multilateral real exchange rate in Argentina in the last 20 years

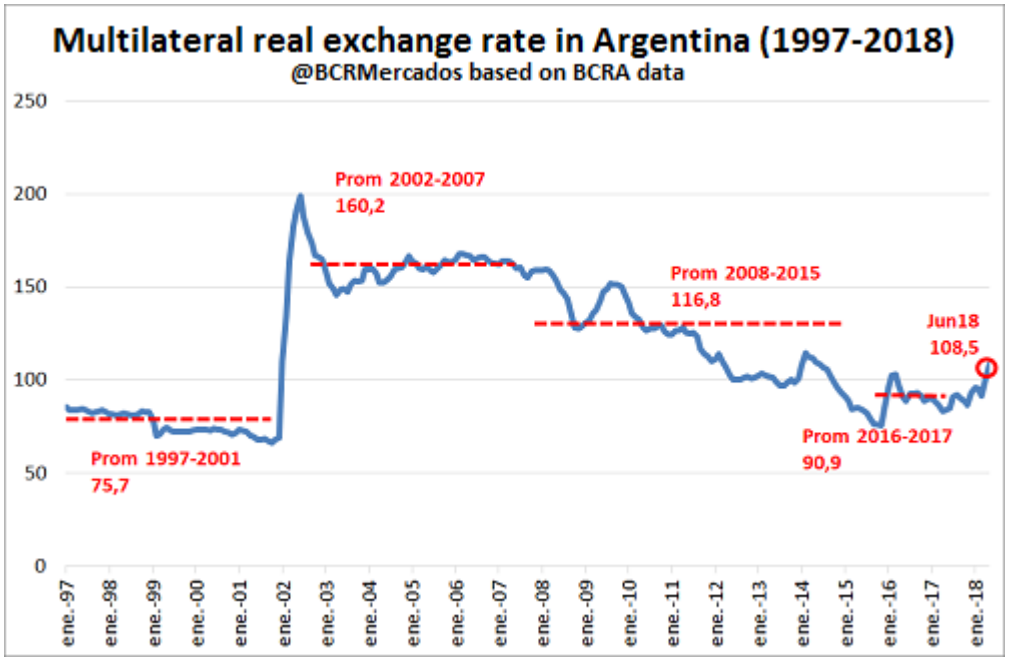
JULIO CALZADA – FEDERICO DI YENNO – EMILCE TERRÉ

Over the last weeks, the increase in the exchange rate in Argentina has attracted much attention, after the price of the local currency reached a maximum around USD/ARS 29 in June. However, it is important to note that this rise is nominal, which does not match at all the Argentine peso's historical minimum purchasing power, as it emerges from the evaluation of the real exchange rate in the 1997-2017 period. In fact, the first graph attached shows the multilateral real exchange rate index (ITCRM) prepared by the Central Bank of the Argentine Republic (BCRA). According to the institution's definition, the index measures the relative price of goods and services of our economy with respect to those of a group of commercial partners of the country. It is calculated from a weighted geometric average of the bilateral real exchange rates of the country's main trading partners. Currently, the index includes 13 commercial partners, considering the Eurozone (19 countries) as a unit. If the Eurozone is broken down, the index consists of 31 countries. In the 1996-2016 period, the joint participation of these commercial partners was between 75% and 83% of the total trade flow considered (exports plus imports). Some of the countries considered for calculating the index are the United States, Brazil, United Kingdom, Canada, Chile, Uruguay, etc. The ITCRM captures the fluctuations of currencies and prices with respect to the main trading partners and is, therefore, a broad measure of competitiveness. It is developed as the ratio of the value of main commercial partners' representative consumer baskets and the domestic basket; all of them expressed in the same currency. The ITCRM is developed and published on a daily basis; to interpret it, it should be kept in mind that an increase in the index implies a depreciation of the local currency in relation to that of the other countries. As a result, this is associated with a price reduction of the Argentine consumer basket that tends to discourage imports and encourage exports. On the other hand, if the real exchange rate falls (supposing that the value of the Argentine consumer basket passes from value 4 to 2) this is identify as a real appreciation of the local currency, which gains purchasing power. That is, while a unit of foreign currency bought 4 Argentine consumer baskets before, it can only buy two now, making our products relatively more expensive in the world. It is worth mentioning that according to the methodology followed by the BCRA, the index excludes commodities traded by Argentina -such as oil and soybean-, since they are homogeneous goods whose prices are mainly determined by supply and demand factors in international markets. Therefore, the country's real exchange rate has little impact on the competitiveness of these productive sectors. What does the Index show after the recent devaluation and how is Argentina now compared to the post-convertibility period? The historical series of the multilateral real exchange rate index (ITCRM) can be used to compare the purchasing power of the local currency at different times. Thus, even with last months' fall of the purchasing power of Argentine peso in relation to the currencies of our main trading partners; June's value of 108.5 is still much lower than the 129.3 average value of the indicator since the exit of convertibility in 2002. The following chart shows the above-mentioned indicator from a historical perspective, distinguishing some well-defined stages, as evaluated by the Central Bank in its November 2017 report.

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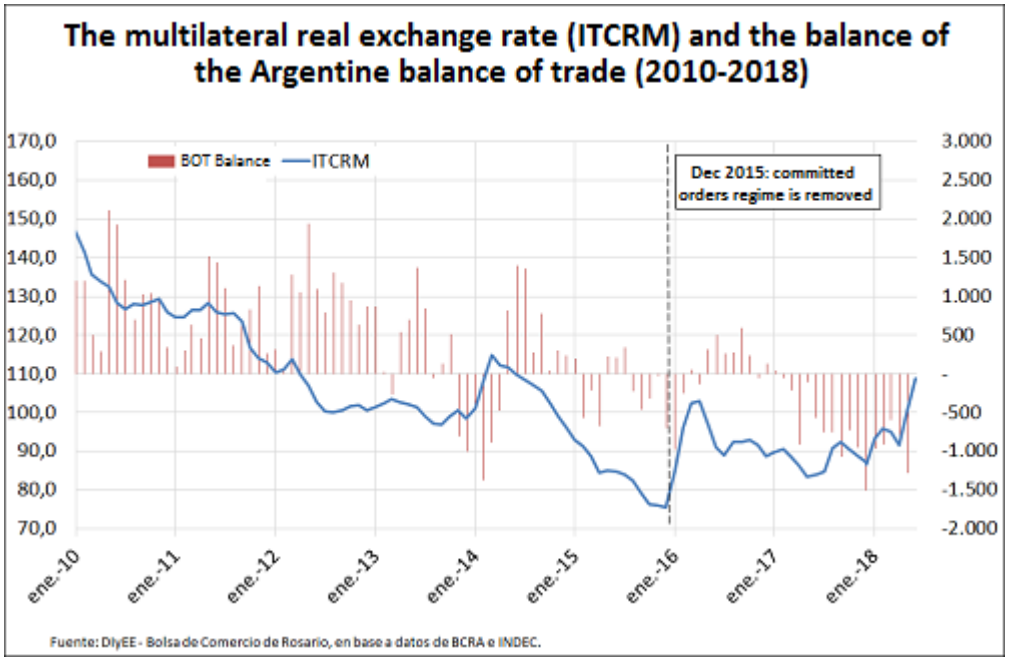


In the BCRA report, it is noted that between 1997 and 2001, during Convertibility Plan, the local currency remained at relatively high levels, in line with a low real exchange rate. As pointed out, this tends to encourage imports and discourage exports. Towards the end of the analyzed period, in 1999, after Brazil devaluated its currency, the index experienced a sharp fall. In the stage that goes from the exit of the Convertibility Plan (and the resulting depreciation of the peso), until 2007, the ITCRM shows a significantly higher real exchange rate. This greater competitiveness of Argentine goods in the world encouraged a significant improvement in the Balance of Trade's balance (which arises from the difference between the goods and services that the country sell abroad and those the country buy). From 2008, the real exchange rate begun a gradual downward tendency. According to the BCRA, this was a consequence of the rise in the general level of domestic prices rather than a reaction to the increase in external prices. Although this trend had slight interruptions due to the nominal depreciations of 2009, early 2014 and the end of 2015, the elimination of exchange controls in 2015 and the laundering in 2016 prompted a significant capital inflow that sustained the downward tendency of the currency. Only in the middle of the current year, the trend reversed and the ITCRM rose to 108.5. Although this value is 19% higher than the ITCRM average for the 2016-2017 period, is still 7% below the 2008-2015 average and 32% below the 2002-2007 average. The multilateral real exchange rate and the balance of the Argentine balance of trade (BOT) Whereas the evolution of the real exchange rate has a great impact on the competitiveness of Argentine goods in the world, in an open economy, the real exchange rate is a variable that is highly correlated with the surplus or deficit of the current account balance of a country, as reported by the International Monetary Fund (IMF). There are several structural factors that may cause a surplus or deficit of balance, such as fiscal and monetary policies, interventions in the exchange rate markets or excessive regulations in labor and goods markets, among others. It is clear, then, that during the periods in which the ITCRM rises are associated with surpluses of the BOT (that is, exports surpass imports); while the falls of the ITCRM are usually associated with a worsening of the external trade deficit. The relationship between the ITCRM and the balance of Argentine BOT is shown in the last graph.

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Along history, increases in the multilateral real exchange rate have generated higher exports and lower imports, as seen in February 2014 and at the end of 2015. Therefore, it is expected that the recent increase in the ITCRM would imply a reversal of the trade deficit and an improvement in the current account deficit that our Argentina presents today.

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