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Changes to the investment approach/process over the past couple of years and going forward: the case of Argentina

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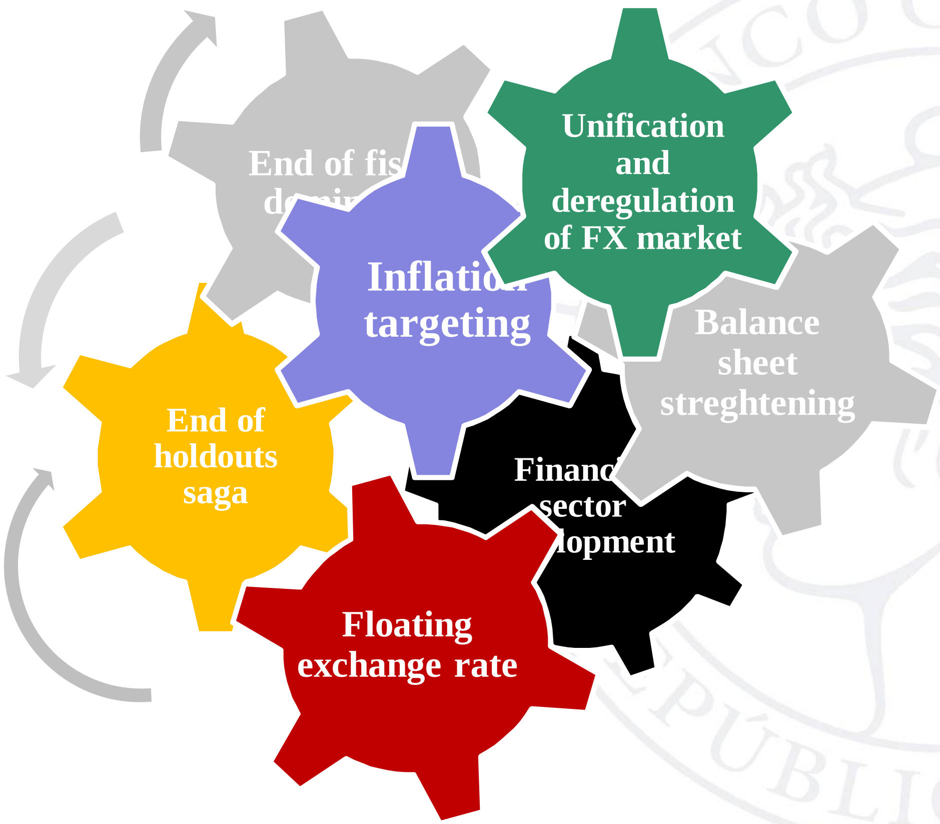
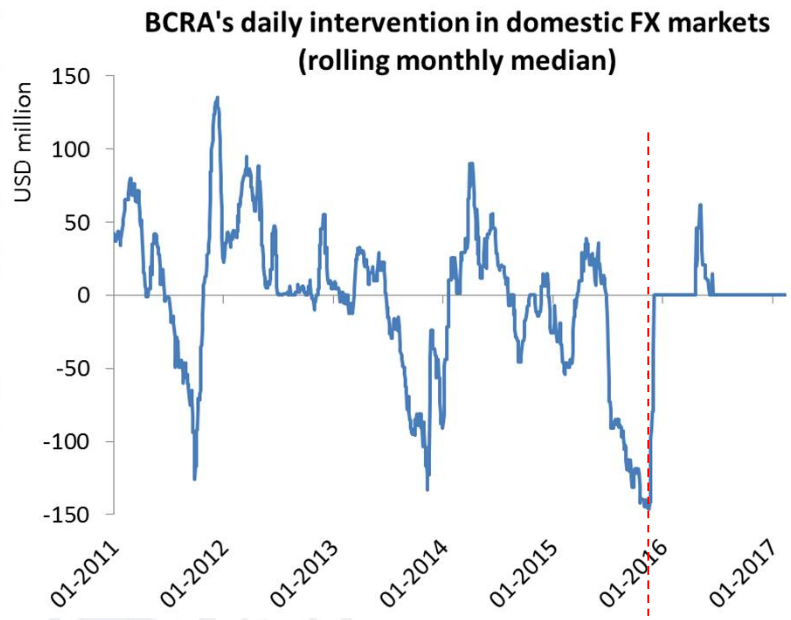
Since December 2015 important changes were introduced in Argentina to rebuild the mechanics and put the engine to work





Jan 3, 2011 - Dec 16, 2015:
1149 / 1205 business days = 95%

Dec 17, 2015 - March 14, 2017:
56 / 307 business days = 18%

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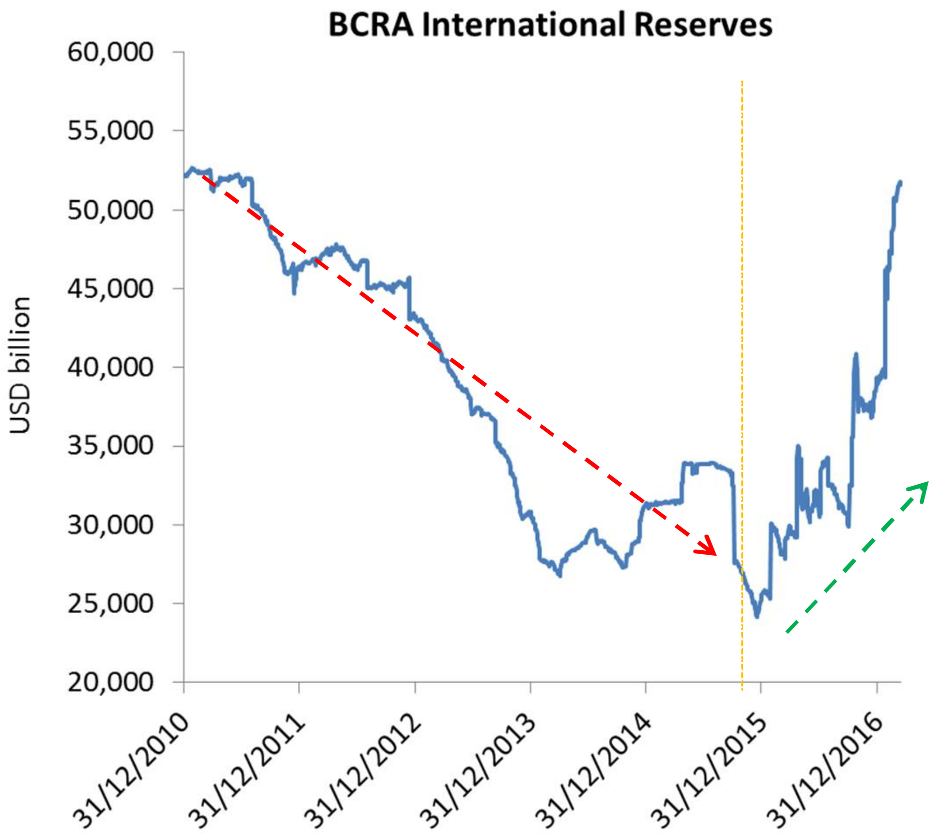
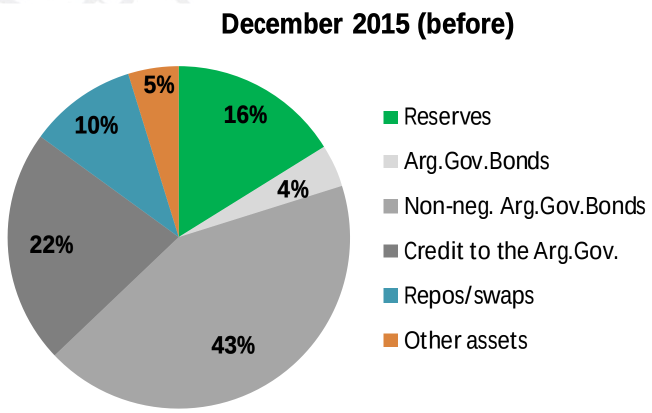
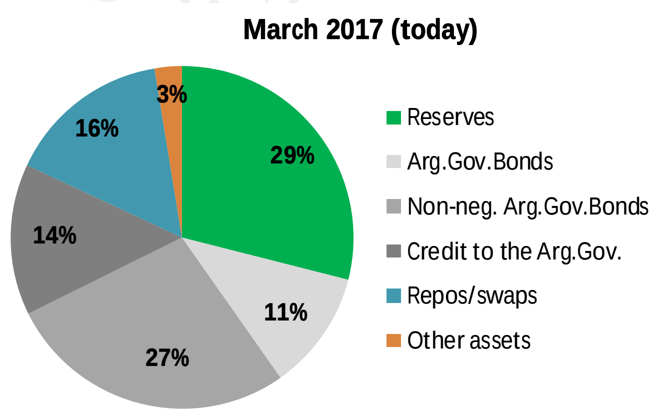
The new mechanics changed the declining trend of international reserves and start to streghthen BCRA's balance sheet



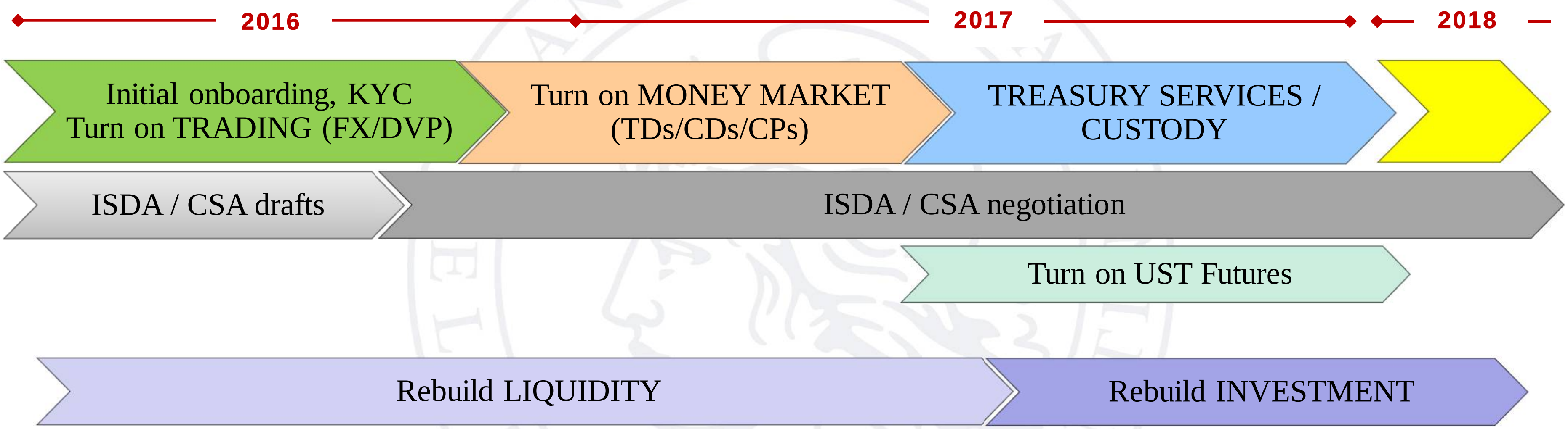
Composition of BCRA assets





The end of a very long saga in US courts reopen the landscape to more competition & efficiency, starting a gradual “back-to-normal” process

“Back-to-normal” stages



Potential shocks/uses:

- ✓ External drain (Guidotti-Greenspan rule)
- ✓ Internal drain (Calvo Rule)
- ✓ Terms of trade

<u>Combined metrics</u>

Wijnholds&Kapteyn, “Reserves Adequacy in EM”, 2001:

STD + 5/20% of M2 x CIR (Country Risk Index)

IMF “Assessing Reserve Adequacy”, IMF Policy Papers, 2011, 2015:

30% of STD + 15/20% of OPL + 5/10% of M2 + 5/10% of X

<u>+ Scenario Analysis</u>

Although some changes have already been implemented, they only became fully operational once the legal contraints were lifted

FROM

ONLY
Official
& safe

TO

Official institutions

+

Private commercial banks:

- ✓ Equity > USD 10 billion
- ✓ Elegible GAFI countries
- ✓ G-SIB designation, or D-SIB designation for countries not having G-SIB

45 elegible banks

FROM

1-VIEW APPROACH

Minimum credit rating (A+)

TO

3-VIEWS APPROACH

CRA	MARKET	MODEL
Minimum credit rating (BBB+)	Max CDS / Z-Spread (300bp)	Max 1yr PD STARMINE/ DRSK

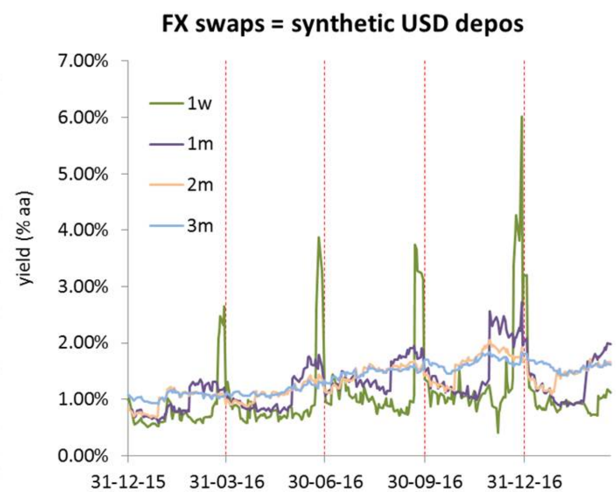
Some other changes were driven by opportunities under the current scenario

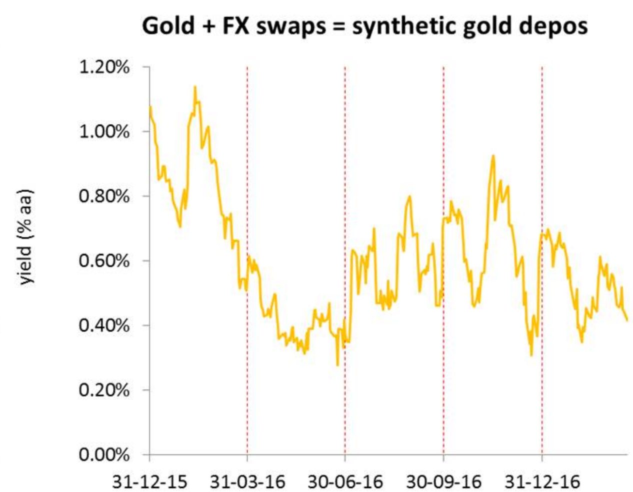
✓ ***Persistence of a cross-currency basis*** ⇨ ***Increased allocation in FX & gold swaps***

~~Covered interest parity~~

$$\cancel{\frac{F}{S}=\frac{1+r}{1+r^*}}$$

$$F-S=S\left(\frac{1+r+b}{1+r^*}\right)-S$$





Why?

2008 ⟶ Global financial crisis, CIP deviations in line with increase in LIBOR-OIS spread

Today ⟶

Why the basis opens up? ⟶ Demand for currency hedges

Why the basis does not close? ⟶ Structural limits to arbitrage (increased regulation)

Borio C., Mac Cauley et all, "Covered Interest Parity lost: understanding the cross currency basis", BIS Quarterly Review, September 2016

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Thank you!