MONTHLY REPORT

ECONVIEWS

ECONOMÍA Y FINANZAS

June 2024

Issue #240

RECENT DEVELOPMENTS

- The Federal Reserve held interest rates at 5.25-5.50% in June and signaled there will be only one 25 bps cut in 2024, instead of the two cuts the market is expecting. The decision set it apart from the European Central Bank which cut rates for the first time in June, and strengthened the dollar worldwide.
- The government scored a political victory and passed the "Ley Bases" reform in Congress, although much of the bill was watered down. Markets had a lukewarm reaction, with country risk hovering around 1,450 bps and the FX spread still at 45%. With growing pressure on the exchange rate front, the Central Bank did not cut rates in June despite inflation decelerating from 8.8 to 4.2% monthly.
- GDP fell 5.1% year-on-year and 2.6% quarter-on-quarter in Q1-2024. The 10% rebound in agricultural activity after the drought helped compensate sharp falls in manufacturing (-14%) or construction (-20%). Unemployment shot up from 6.9 to 7.7% in Q1, the highest since the pandemic.
- The government had its fifth straight primary surplus in May, accumulating 1.1% of GDP so far this year. Construction companies are complaining about the 78% real cut in public works, which have sent the sector into a deep crisis.

FIGURE OF THE MONTH

May's CPI print was

4.2%

the lowest monthly figure since January 2022.

TO BE ALERT

The Central Bank had net sales of USD

47 mn

in the FX market in June.

WHAT'S COMING NEXT?

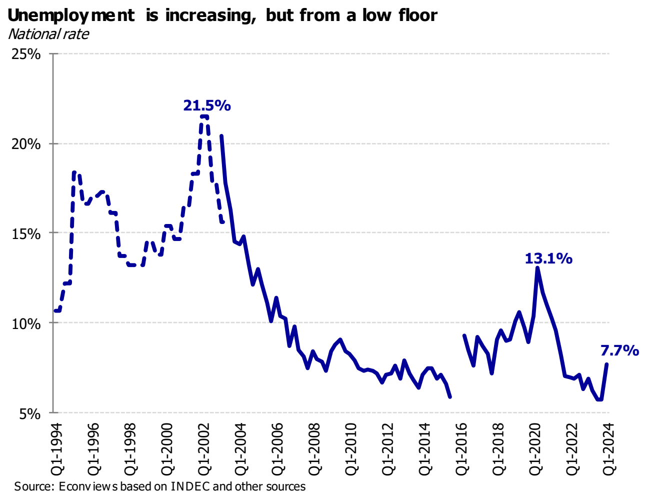
- After the "Ley Bases" and the fiscal package passed in Congress, the government promised to lower the PAIS tax on dollar purchases from 17.5 to 7.5% in August, a move that would cost approximately 0.5% of GDP, only partially offset by increasing income tax for salaried workers, with an impact below 0.3% of GDP in 2024.
- A chorus of voices, from the IMF to several market economists, are pointing at inconsistency in the government's exchange rate policy. Milei and Minister Caputo have both insisted there will be no step devaluation of the official rate. However, the widening FX spread and weak Central Bank purchases in the FX market suggest the peso is becoming overvalued. The spread between CER (inflation-adjusted) and dollar-linked bonds is pricing a new real devaluation by March 2025. The dollar has strengthened against other emerging currencies including the Brazilian Real which is down 12% YTD.
- After delivering five months of surplus, will the government slip into primary deficit for the first time in June? Mid-year bonuses for employees and weak revenues from VAT, social security contributions and export duties will complicate fiscal accounts, although there are still a few aces left such as deferred taxes on credits and debits from May. However, real exchange rate appreciation and use of zero-coupon bills will also lower interest payments to GDP in 2024.

SUMMARY OF MAIN INDICATORS

	Last	Previous		Last	Previous
Economic activity			**Financial data**		
Economic activity (MoM s.a.)	-1.4%	0.0%	Inflation (monthly)	4.2%	8.8%
Consumer confidence (MoM)	-2.8%	3.1%	FX spread (21day avg.)	41.1%	27.1%
Industrial activity (MoM s.a.)	1.8%	-4.1%	Country risk (bps 21day avg.)	1,441	1,243
International accounts			**External data**		
Current Account (USD BN)	0.24	-2.67	Soybean price (per ton, 21day avg.)	433.7	446.7
CB Reserves (USD BN 21day avg.)	29.24	28.81	Brazilian activity (MoM s.a.)	0.0%	-0.4%
Primary balance (ARS BN)	2,332.2	265.0	Financial Conditions Index	35.9	34.9

Source: Econviews based on multiple sources - working days only

GRAPH OF THE MONTH:



RECENT ECONOMIC DEVELOPMENTS

MAY 30th	JUN 4th	JUN 12th	JUN 13th	JUN 17th	JUN 27th	JUN 28th
Econviews Monthly #239: A second stage for economic policy + special report on the Provinces' fiscal accounts.	Lower House votes **new adjustment in pensions which implies 0.5% of GDP expenses**, Milei promises to veto bill.	**Senate narrowly approves reform bill**, but votes against fiscal package, Lower House gets last say on both issues.	**May's CPI at 4.2% monthly**, lowest in over 2 years, paired with reform bill, sovereign bonds and stocks up 5%.	IMF finishes 8th review of EFF program, disburses USD 800 million but is **very critical of exchange rate policy**.	**Lower House gives final sanction to "Ley Bases"**, Milei says Sturzenegger will join cabinet.	**Econviews Monthly #240**

POLITICS

After months of negotiations and setbacks, the government finally managed to pass a watered-down version of its "Ley Bases" reform bill through Congress, with the Senate's approval. The Lower House's vote saved the fiscal package. Milei's image remains positive according to most polls, though the Di Tella Government Confidence index slumped 2.1% in June and is below the same period of the Macri or Fernández administrations. The positive side is that the government showed it can coordinate with the "friendly" opposition to pass laws, the negative side is that it has eaten up some of its political capital in a long and costly process.

IMF

The IMF approved the eighth review of the program enabling the arrival of USD 800 million in mid-June. The Fund applauded the government's aggressive fiscal policy, suggesting it would have settled for a less ambitious target. However, it insisted on the need to increase income tax for workers, in order for the adjustment to be sustainable in time. It was more critical on exchange rate policy, insisting on the need to gradually remove FX controls and set a positive real interest rate. Milei lashed out against the IMF after the staff report.

ECONOMIC ACTIVITY

GDP slumped 5.1% year-on-year in Q1-2024, falling 2.6% against the previous quarter. In April, construction (+1.7%) and manufacturing (+1.8%) posted monthly rebounds, but initial data for May are mixed, pointing at a tepid recovery at best. 105,000 formal jobs were lost between Q4-2023 and Q1-2024, almost half of them in the construction sector. Unemployment increased from 6.9 to 7.7% in the last year, although it is still far from the pandemic's double digit measures. While March may have been the floor for activity, the chances of a V-shaped recovery are less and less, with reforms advancing slowly and the appreciated exchange rate weighing on export-led sectors and construction, whose costs are high in dollars.

INFLATION

May's CPI print came in at 4.2%, below most market forecasts, the lowest monthly register since January 2022. Food and beverages rose 4.8% and services like restaurants and hotels (+5.5%) or education (+7.6%) led the general index, but they were contained by utilities which increased only 2.5% after adjustments were postponed. Our survey of online supermarkets shows food and beverage inflation had two straight weeks of nearly 0% variation in June. However, the delayed hikes in utilities and inertia in wage inflation leads us to think inflation will be stuck around 5% in coming months. We lowered our forecast for the full year from 171 to 160%.

MONETARY SECTOR

The Central Bank did not cut rates in June. Between March and May it had lowered its policy rate from 100 to 40%, 20-points each month. But the recent increase in parallel exchange rates which widened the FX spread from 20 to 45% spooked authorities. 40% APR is still negative in real terms, as it is an effective monthly yield of 3.3%, below expected inflation. One argument is that now the Treasury sets policy rates, and its bills are at 4.25-4.5% monthly. But fixed term deposits are still referenced in Central Bank rates. June was a bad month in terms of reserve purchases, with the Central Bank with net sales of USD 47 million despite the harvest, a warning sign for exchange rate appreciation.

FISCAL ACCOUNTS

The national public sector ran its fifth consecutive primary surplus of ARS 2.3 trillion in May, a fiscal surplus of 1.2 trillion. The accumulated primary surplus in five months of 2024 reached 1.1% of GDP. Tax revenues soared 10% year-on-year in real terms thanks to extraordinary corporate income tax collection (+93%), as the December devaluation created huge capital gains for companies which held dollar-linked assets. Primary expenses are down 29% year-on-year, with the focus of adjustment slowly shifting from pensions and social spending (-18%) to energy and transport subsidies (-32%). CAPEX is still down 78% in real terms. We expect a 0.5% primary surplus for all 2024, a 1% fiscal deficit after interests.

I. FX policy, between a rock and a hard place

Finally, Milei is getting the approval of the first laws: the "Ley Bases" reform bill, and the fiscal package. This is an important political victory, and it indicates that when push comes to shove, he is willing to compromise. Much of the merit goes to his new Chief of Cabinet, Guillermo Francos, who proved to be a shrewd and tireless negotiator, though it is clear that Milei supported him throughout this process.

While this is good news, Milei continues to be in a fragile situation in Congress. He needed to twist arms and make concessions to get the laws approved, which he can only do for specific cases. His best bet continues to be to do well in the mid-term elections next year to consolidate his position.

So far, his popularity has remained high, though some opinion polls indicate that he is facing some erosion. His main achievement, and the one people applaud, has been the reduction in inflation, which has been reached at the cost of a deep recession and a big drop in people's incomes. However, we are starting to see a change in priorities as the concerns about the recession are slowly taking center stage. The big issue is that the policies to stimulate the economy are not as clear cut as those to reduce inflation. Milei does not believe in Keynesian policies (which are the bread and butter in the profession), while the structural reforms stimulate supply and investment work slowly as they take time to implement and time to have effects on business decisions. So, no impact whatsoever in 2024.

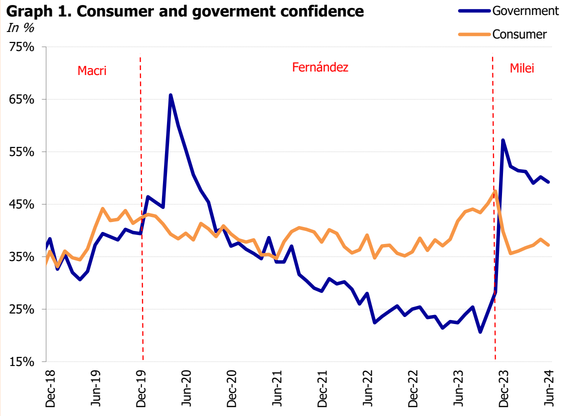
Perhaps the most important policy action that the administration can take at this time to stimulate the economy is the removal of the FX restrictions, though there has been little progress on this front, as very few restrictions were removed so far, and in some cases, they were reinforced. The reasons for eliminating the restrictions are twofold. On the one hand it will remove the sand on the wheel to operate in FX market and hence ease everyday transactions that are critical for production and for securing external financing for imports and investment. Equally important, it will remove a source of uncertainty regarding the evolution of the exchange rate, interest rates and inflation that are paralyzing investment and production in many sectors.

The government has stated some monetary pre-conditions for the removal of the "cepo". Most of these priors have been largely met (namely the reduction of central Bank liabilities, or the cleanup of debts related to unpaid imports and dividends that were significantly reduced through the issuance of Bopreals). These risks cannot be fully eliminated, but they are now at manageable levels.

The only remaining pre-condition that is still pending is to have a stock of 10 to 15 billion dollars of reserves to have more firepower to deal with turbulence in the FX market. In this area it does not seem that the government will be able to achieve successes it in the near future. In fact, the situation has been deteriorating recently as the Central Bank has not been able to increase reserves in recent weeks.

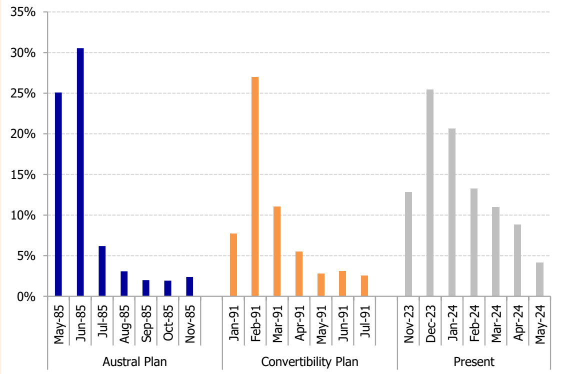
There has been a change in sentiment in the market regarding the sustainability of the current exchange rate policy, especially about the

Graph 1. Consumer and goverment confidence
In %



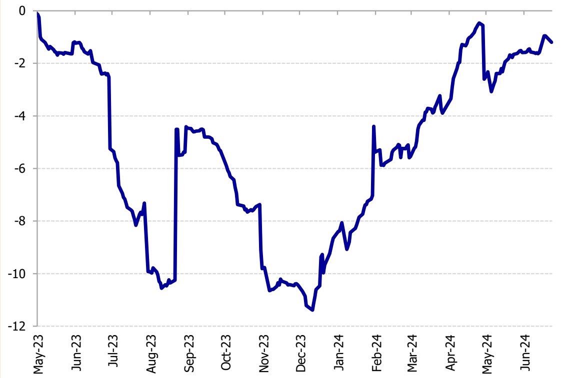
Source: Econviews based on UTDT

Graph 2. Inflation after stabilization plans
Monthly variations

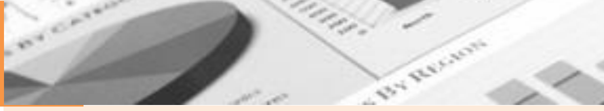


Source: Econviews based on INDEC

Graph 3. Net International Reserves
In billion USD



Source: Econviews based on BCRA, IMF & own estimates



viability of keeping the depreciation of the currency at 2% per month. The concerns were exacerbated by the Central Bank decision to reduce the policy interest rate dramatically to 40%, which in effect it implied a very low yield for peso instruments. That decision was probably the trigger for the ensuing events, which were mainly a rebound of the parallel exchange rates, that had remained dormant between February and May.

The main problem is that the current spread between the official and the parallel exchange rates that stands now at 50% will be difficult to revert in the absence of a large increase in interest rates, which the Central Bank is unlikely to implement. Hence the appetite for dollars will remain high. Under these conditions we do not see a significant drop in the spread.

The government is probably waiting to see if the final approval of the two laws makes a dent on the spread, though it seems that by now markets have revised their expectations and it will be difficult to happen. On the other hand, the laws can improve the outlook on investment (especially thanks to regime for new large investments, namely the RIGI), and help to reduce the country risk. But again: it will not happen overnight.

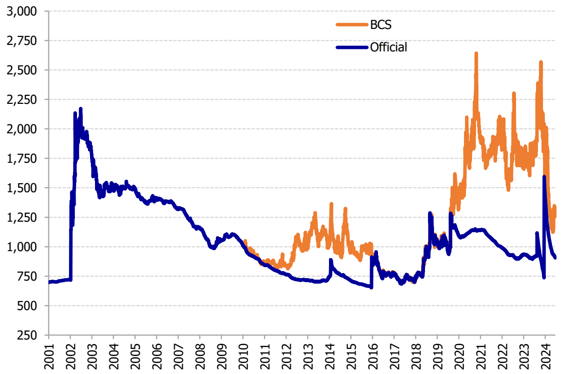
The bottom line is that on the exchange rate front there are no easy ways out. The removal of the cepo requires the unification of the exchange rate, and experience shows that in cases in which there is a large spread between the official and the parallel exchange rates, the unification takes place at or closer to the parallel rates. This implies a sharp devaluation.

The government seems to be between a rock and a hard place. Unifying the exchange rate will generate a bout in inflation, which even if is temporary and controlled might be seen as a setback in terms of economic objectives. Not unifying the exchange rate and keeping the cepo will complicate the recovery, maintain uncertainty and delay investments.

Perhaps it is time to consider alternative options such as adopting a dual exchange rate system, in which there is a commercial exchange rate that is used for imports, exports and few other transactions that the Central Bank can continue to manage (perhaps increasing somewhat the rate of depreciation). There is also a free o financial exchange rate that floats freely and is used for all other transactions, including services such as tourism, royalties, etc. However, this should be a temporary regime to deal with the transition to the unified market which does avoid the potential pain of higher inflation if by the time of unification of the FX market there is still a large spread between the official and the parallel exchange rates.

Where does all these leave us? Probably better than might look at first glance. There has been significant progress on the fiscal side, where the government has maintained a surplus during the first five months, there was significant progress in liberalizing imports, in eliminating distortions in relative prices, and in some structural reforms. It seems that the main stumbling block to move to a "normal" economy is the elimination of the cepo and the adoption of a more standard monetary and exchange rate system. **It is surprising that a government that did not hesitate to bring down the fiscal deficit by five percentage points of GDP risking a social crisis is so hesitant about removing the cepo that Macri eliminated in one stroke.**

Graph 4. Exchange rate at constant prices
At Jun-24 prices - Adjusted by ITCRB



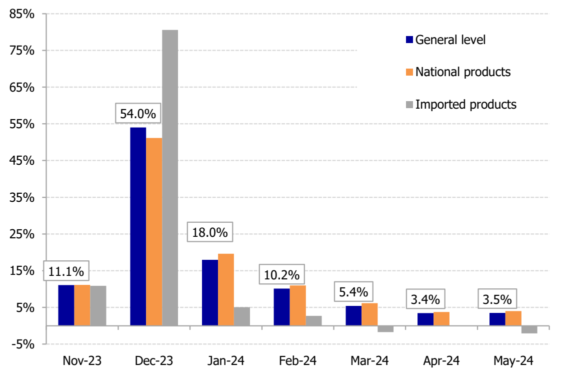
Source: Econviews based on BCRA

Chart 1. IMF Forecasts

	2023	2024	2025
GDP Growth	-1.6%	-3.5%	5.0%
Non-agro GDP	-0.8%	-6.0%	5.0%
Inflation (Dec)	211.4%	139.7%	45.0%
Primary fiscal balance (% of GDP)	-2.9%	1.7%	2.3%
Overall fiscal balance (% of GDP)	-4.6%	0.0%	0.5%
Current account balance (% of GDP)	-3.4%	0.6%	0.8%
Accum. of net reserves (USD bn)	-16.4	7.0	5.0

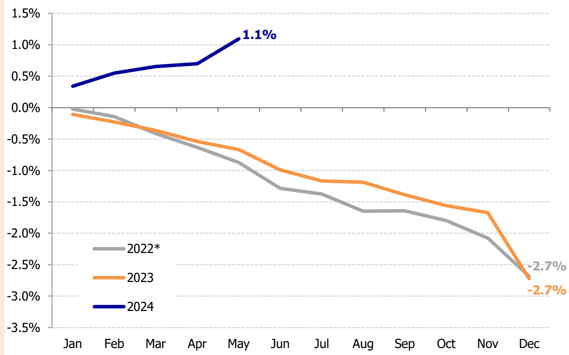
Source: Econviews based on FMI

Graph 5. Wholesale prices
Monthly variations



Source: Econviews based on INDEC

Graph 6. Primary result
Accumulated as a % of GDP - National government, cash basis



2022* excludes rents from CER bond issuance
Source: Econviews based on Min. of Economy and INDEC

ECONVIEWS
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II. Everything you want to know about how to remove FX controls

This section has three main objectives. **First, to understand the factors underlying the expansion of the monetary base in the current monetary and exchange rate regime**, and what role the Central Bank's interest-bearing liabilities have had in this process. We find that these liabilities have not been the principal factor in the monetary base's growth, nor have they hindered monetary policy in these past years (a subject we covered in our May 2023 report on the sustainability of Leliqs, then the Central Bank's key instrument).

Second, to analyze the effects of lifting the cepo and unifying the exchange rate market on interest rates, the exchange rate and money supply. The key is to understand the new exchange rate regime (whether there will be a free float, a dirty float, a new crawling peg, exchange rate bands or some other variant). A central aspect of this analysis is to understand what will happen with the interest rate once controls are removed, and which anchor for monetary policy is chosen (monetary aggregates, exchange rate or interest rate).

Third, to discuss the viability of the three alternatives to dollarize the economy: total dollarization like in Ecuador or Panama, "endogenous" dollarization by freezing the monetary base and forcing the use of hoarded dollars as pesos become scares, and finally a competition of currencies.

i. How things work with FX controls

Argentina has had strict FX controls in place for several years, leading to a split between official and parallel exchange rates (Blue Chip Swap or MEP rates), the latter determined mainly by market forces in spite of being subjected to some restrictions.

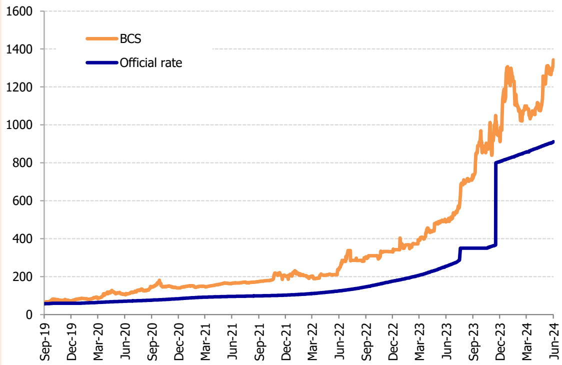
The monetary regime is one of "financial repression". Since pesos cannot be freely converted and are thus "trapped" within the country, the Central Bank can set interest rates at very low levels, as it has done in the last few months.

Under financial repression (i.e. the cepo) the Central Bank can fix both the official exchange rate and interest rates at the cost of having a floating parallel exchange rate and losing control of the monetary base, which in fact becomes endogenous.

The fixed exchange rate means the Central Bank buys or sells dollars (reserves) and prints or absorbs pesos at that exchange rate. Likewise, the Central Bank also sets the policy interest rates and banks decide how much liquidity they want to hold, forcing the CB to absorb or relax liquidity. In other words, The Central Bank losses control of the monetary base.

Banks manage their liquidity through reverse repos (previously Leliqs). Interests on these liabilities can expand the monetary base, though banks have tended to reinvest both capital and interest, so this has not been a

Graph 1. FX market
ARS/USD - average b/a



Source: Econviews based on Reuters

key driver of monetary base growth. Of course, these interest-bearing liabilities have soared in nominal terms.

We can thus present the evolution of the monetary base as a result of intervention in the official FX market, on the financial operations with the Treasury (mainly through temporary advances or the Treasury's deposits in the Central Bank) and in the decision of banks of hold interest bearing Central Bank liabilities (counting capital and interest). The Central Bank has also conducted operations like buying or selling government bonds in the secondary market and selling puts to banks that wanted a "liquidity" hedge, all registered in the "others" account.

A simple way to show the evolution of the monetary base displays these four factors:

$$\Delta MB = E\Delta R + \Delta(B_{T_t} - B_{T_{t-1}}) - \Delta[B_{CB_t} - (1+\bar{i}_{t-1})B_{CB_{t-1}}] + \phi$$

Where *MB* is the monetary base, *E* is the nominal exchange rate, *R* is the Central Bank's international reserves, B_T is the Central Bank's holdings of Treasury bonds (an approximation to financing of the public sector and the Treasury's deposits in the Central Bank) and B_{CB} is the banking sector's holdings of Central Bank interest-bearing bills or bonds. *Φ* is a residual for other factors of expansion/contraction of the monetary base.

The first two terms are standard and show that the purchase (sale) of FX reserves lead to expansion (contraction) of the monetary base. Issuance to finance the public sector is expansive, while an increase in Treasury deposits in the Central Bank is contractive. The last term represents the net issuance of Central Bank interest bearing liabilities, in other words the net amount that banks roll over or redeem to manage liquidity, which impacts on the monetary base. This last variable has not had an important effect in recent years regarding changes in the money supply as they have tended to rollover capital plus interests as is being shown the table below.

Finally, other components like the payment of banks' puts or profit/losses from operations with government bonds on the secondary market, or intervention in the dollar futures market, also affect the monetary base, though in low amounts.

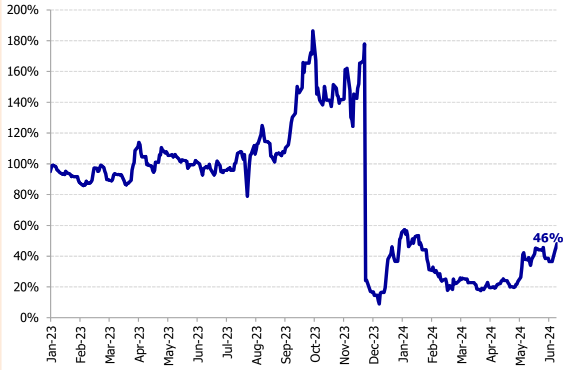
As you can see in chart 1, the Central Bank's interest-bearing bills contributed to a contraction of the monetary base, even once we consider the interest payments on them. Only in 2023 the interest bill was higher than the capital rollover of Leliqs and Repos as interest rates were hiked to control parallel exchange rates.

The expansion was due mainly to financing of the Treasury and to the purchases of Treasury bonds. Once the new program with the IMF was in place the Central Bank started to finance the Treasury indirectly through operations in the secondary debt market (included in the "Others" category) to avoid breaching the program targets.

¿Can the Central Bank control the monetary base in this model? The answer is no, because the Central Bank controls or expands it passively according to what happens in the exchange rate market with banks' liquidity needs. **By fixing the exchange rate and interest rate, the quantity of money is endogenous.** The corollary is that the **contraction in money issuance in the first months of 2024 was due to the collapse of**

Graph 2. FX spread with BCS

Vs the official exchange rate, in % - Average b/a



Source: Econviews based on Reuters

Chart 1. Monetary Base - Factors of variation

In million ARS

	2020	2021	2022	2023
Leliqs + Notaliqs	-900,692	-134,168	-5,839,380	6,134,847
Reverse Repos	-710,187	-1,754,180	864,339	-22,119,002
Total	-1,610,879	-1,888,349	-4,975,040	-15,984,155
Interests	721,559	1,346,054	3,386,279	16,327,458
Net effect	**-889,320**	**-542,295**	**-1,588,761**	**343,303**
Reserves purchases	-312,175	451,755	1,479,274	2,466,311
Public sector*	1,835,992	1,763,269	10,837	-3,566,636
Others	-59,616	-488,954	1,648,367	5,161,261
Monetary Base variation	**574,881**	**1,183,776**	**1,549,716**	**4,404,240**

*Includes reserves purchases, transitory advances, profit transfers & other opertations.

Source: Econviews based on BCRA

the demand for money, to which the supply of money reacted only passively. The policy of "cleaning the Central Bank's balance sheet" did not play a significant role in controlling monetary base growth, it only helped to lower the Central Bank's interest-bearing liabilities.

With FX controls, as we previously showed, the Central Bank can manage the exchange rate and interest rate, while the monetary base and parallel exchange rate are determined by the market.

An additional concern is that since Central Bank liabilities have been converted into Treasury bonds and bills, some aspects of monetary policy are now in the hands of the Treasury. In other words, **the Treasury is taking over functions that are inherent to the monetary authority**.

This can be seen when the Treasury absorbs liquidity issuing Lecaps (zero coupon bills) and deposits the funds in the Central Bank. **The Treasury is acting as a "middle-man" for the Central Bank to sterilize pesos**. When in an Lecaps auction Lecaps the Treasury gets net positive funding (i.e. it issues more than the financing needs) it deposits the excess funds at the Central Bank, in effect sterilizing pesos. This is the case since banks were induced to shift the pases to Lecaps, meaning that they now hold their excess liquidity mainly in Treasury bills and bonds, as opposed to Central Bank instruments. An interesting point is that now the Treasury also sets the reference interest rate, which is the one on short-term Lecaps.

This is certainly a new experiment, because almost everywhere the Central Bank is the institution in charge of managing liquidity and interest rates.

This regime poses some interesting questions. For example, what would happen if all of a sudden banks need liquidity and want to redeem their Lecaps. Would the Treasury have the funds to do it or would it need to resort to the Central Bank to money and act as a lender of last resort? Does the Central Bank have under this regime any instruments to sterilize pesos that would be issued to buy dollars in the market? Would it have any firepower to run monetary policy? Or perhaps one could argue that this is part of the process that Milei has in mind to close the Central Bank.

What seems clear, though, is that in the effort to remove the interest-bearing liabilities from the Central Bank, the institution has lost firepower to set monetary policy. The typical Central Bank functions of managing liquidity and fixing interest rates now shared between the Treasury and Central Bank.

ii. ¿What changes if FX controls are lifted?

Removing controls and unifying the exchange rate mean important changes in monetary policy. In principle, it implies unifying the exchange rate, since restrictions to operate in the FX market would be eliminated, with freedom to buy or sell dollars at a single price.

At that moment the Central Bank will have to choose the monetary and exchange rate regime that it will adopt, something crucial to understand where the exchange rate and interest rates, currently fixed, will go.

The Central Bank will have to choose between controlling.

1. **The quantity of money, as it did under the IMF program in August 2018 when it set a 0% target for monetary base growth**. In this case the interest rate would be market-determined and the exchange rate would float (as was the case in the 2018 experiment).

2. **The exchange rate, either with a crawling peg similar to the current one or a fixed rate like in the 1991-2001 Convertibility**. In those cases, the interest rate will be determined by the expected devaluation rate (as occurs with competing currencies) and the quantity of money evolves in line with the demand for money.

3. **The interest rate, as was the case during Sturzenegger's term at the Central Bank, when the exchange rate fluctuated without major intervention (except in early 2018 during a run against the peso).** The quantity of money was in principle endogenous, although the Central Bank sterilized part of the money issue resulting from reserve purchases though Lebacs (interest-bearing letters).

The most likely scenario is that the Central Bank will choose to maintain some control of the exchange rate in the short term, fearing a new overshooting that could destabilize inflation. Therefore, a new hybrid regime, such as a dirty float, is a likely option.

Another "hybrid" alternative is an exchange rate band where the Central Bank determines upper and lower bands. In this system, the exchange rate is allowed to float within the band, but it would become a fixed rate if it stays at the floor or at the ceiling. If it sticks for too much time at one of the extremes it would be sign that the band limits would need to be redefined.

This exchange rate band regime has some complications, such as defining the width of the bands (in the 2018 program the bands were ridiculously wide, in practice a floating rate). Other issues are if the band is static, or if the floor and roof evolve in line with a crawling peg, if the Central Bank can intervene within the band, and so on.

Finally, there is the possibility of a transition with two exchange rates, known as a dual system or "decoupling". Generally, there is a commercial exchange rate used for import and export of goods, in which the Central Bank intervenes, for example, by setting a crawling peg. There is a separate market for financial operations and some services (like tourism), in which the exchange rate is allowed to float.

The advantage of the dual system is that, if there is for example a stock of pesos "trapped" in the local market that wishes to escape, it would pay a premium (the spread between the commercial and free exchange rates) and that increase in the exchange rate would not impact fully on inflation, because goods transactions would still be carried out at the official rate. However, if this spread is maintained for more than a couple months, it would begin to generate distortions and incentives to arbitrage between rates, which affects prices and international reserves. **A dual exchange rate could only be a temporary and second-best solution,**

As long as there are FX controls	If FX controls are removed
The Central Bank can fix the exchange rate and interest rate (there is financial repression).	In principle the exchange rate would be unified, going to a more traditional monetary regime.
	Experience shows that exchange rate unification occurs closer to the parallel or free rate than the official one.
The quantity of money (including the monetary base) is endogenous and depends on the demand for money.	In the new regime the Central Bank would have to choose between controlling the exchange rate, the interest rate or the quantity of money. Once it chooses one of the variables, the other two are determined endogenously by market forces.
The parallel exchange rates are the safety valve to a disequilibrium in the monetary market and are determined by similar factors as a free floating single exchange rate	There are also hybrid systems like a dirty float or exchange rate bands, but in general terms, both are variants of a floating rate.
	There is the possibility of a transition regime with dual exchange rates, with a controlled official rate and a free financial rate which can also be used for service payments, without controls to operate in each market. But this would be a temporary solution to clear the "trapped" pesos (which are surely less at this point).

iii. Myths and realities of the three roads to dollarization

Dollarization understood as replacing pesos with dollars is not viable at this time, simply because the necessary dollars are not available. International reserves are barely enough to remove controls, and to service the debt, there are no excess reserves to dollarize. Besides, the Central Bank has not been accumulating enough dollars to overcome the shortage. The government is not insisting on this option and the IMF's latest staff report implicitly considers that it is not on the table any more, and therefore, it is not worth discussing it.

There are two other interpretations of the government's intentions. One is the so-called **endogenous dollarization. The assumption is that if the government fixes the monetary base at the current level at some point there would be a scarcity of pesos and Argentines would be forced to use their own dollars for transactions. The economy would spontaneously dollarize drawing from hoarded assets.** For this alternative to be viable, it would have to be implemented at par with a floating exchange rate, since that is the only regime where the Central Bank can fix the quantity of money.

The first problem with that option is that today banks have excess liquidity in repos and Lecaps, whose stock will surely start to drop as banks increase credit to the private sector. This will require the Central Bank to expand the monetary base. In the case of repos, this will be a direct expansion, while in the case of Lecaps, if banks do not roll over them as they mature, the Treasury will have to draw from its deposits at the Central Bank, indirectly expanding the base. Therefore, fixing the monetary base is more complicated than it seems.

The second problem is that drying up the peso market will not only lead to more exchange rate appreciation (which is what the defenders of endogenous dollarization have been saying), it will also raise interest rates significantly. Bank loans, including overdraft, credit cards, etc. work in pesos. Gradual dollarization could only work if there are sufficient changes in the institutional, regulatory and payments-system reforms so that the banking system starts to work in dollars. But was we already mentioned, there is a shortage of dollars which prevents dollarization of the monetary base and of bank deposits, making this option non-viable.

The third option, which looks the most likely, is going towards bi-monetarism or competition of currencies. Of course, the first step towards this option is to unify the exchange rate, so that dollars can be traded freely and people can choose which currency to use. The monetary regime should be similar to Peru or Uruguay's. For it to work, along with unifying the exchange rate, legislation should facilitate transactions and contracts in both currencies.

In Peru and Uruguay both currencies coexist, and with time the local currency, both the Uruguayan Peso and the Peruvian Sol, have recovered ground, evolving from a purely transactional currency to one that is used for long-term savings. In Lima it is possible to get a 30-year mortgage in soles, for instance.

By and large, this is not very different from the Argentine Convertibility, albeit we are not talking here about a fixed exchange rate. In that decade, both currencies coexisted. During those years there were 10-year bond issues and mortgages, in pesos at fixed rates. It is possible to have bi-monetarism without the peso being the obvious loser, but this depends primarily on the quality of economic policy.

The idea of dollarization was attractive last year as a quick mechanism to eliminate inflation. With time, as doubts began to appear, alternatives like the endogenous dollarization popped up. However, this is not a viable option either. The third alternative was currency competition, which can probably work in the medium term, but not as an anti-inflationary strategy.

Base Scenario

	2022	2023 E	2024 F	2025 F
Inflation (eop)	94.8%	211.4%	160.0%	59.0%
Exchange rate ARS/USD (eop)	177.1	808.5	1,562.7	2,293.6
Exchange rate ARS/USD (eop, YoY)	72.4%	356.4%	93.3%	46.8%
Real exchange rate ARS/USD (eop, Dec-01=100)	129.8	196.4	152.5	144.3
Paralell exchange rate ARS/USD (eop)	340.8	972.8	1,562.7	2,293.6
Spread with official exchange rate (eop)	92.4%	20.3%	0.0%	0.0%
Gross reserves (USD billion, eop)	44.9	23.1	33.4	40.0
Net international reserves (USD billion, eop)	7.7	-8.6	1.4	8.0
Policy rate (eop)	75.0%	100.0%	80.0%	45.0%
GDP (YoY)	5.3%	-1.6%	-3.6%	5.0%
Formal wages in real terms (aop, YoY)	0.3%	-1.2%	-4.3%	3.9%
Primary result (% GDP)*	-2.7%	-2.7%	0.5%	1.0%
Fiscal result (% GDP)*	-4.1%	-6.0%	-1.0%	-1.0%
EMBI Argentina (spread in bps, eop)	2,196	1,907	1,000	600
Current account (% GDP)	-0.7%	-3.3%	0.9%	1.3%

Source: EconViews

*Excludes rents from primary debt issuance in 2022

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