

EBS/83/167

CONFIDENTIAL

August 9, 1983

To: Members of the Executive Board
From: The Acting Secretary
Subject: Argentina - Real Effective Exchange Rate -
Information Notice

The attached information notice on a change in the real effective exchange rate of the Argentine peso is circulated for the information of Executive Directors.

Att: (1)

INTERNATIONAL MONETARY FUND

ARGENTINA

Real Effective Exchange Rate--Information Notice

Prepared by the Western Hemisphere and Exchange and
Trade Relations Departments

(In consultation with other departments)

Approved by E. Wiesner and Manuel Guitian

August 8, 1983

The recent evolution of Argentina's real effective exchange rate, as measured by the standard index developed in connection with the information notice system, is set out in the attached table and chart. ^{1/} Based on this index, as of June 1983 the Argentine peso had appreciated in real effective terms by more than 10 percent since the last occasion on which the Executive Board had an opportunity to discuss Argentina's exchange rate policy--the 1982 Article IV consultation and the approval of the stand-by arrangement in January 1983.

Using seasonally adjusted data for consumer prices, the real effective appreciation from January to June 1983 was 15.1 percent, including a rise of 5 percent in June. The high and variable monthly rates of inflation in recent years make it difficult to sort out seasonal elements and the statistical seasonal adjustment factors are highly unstable; if the unadjusted price index is used the real effective appreciation over the five months was 11.7 percent. These calculations rely on staff estimates of price developments in some of Argentina's trading partners in recent months and are subject to revision when actual data become available. The real effective appreciation since January followed a real effective depreciation over the two previous years in excess of 60 percent.

As part of Argentina's economic program, which is supported by a Fund stand-by arrangement, the exchange rate is to be adjusted with sufficient flexibility to meet the balance of payments objective of the program. Within that general objective, the short-run policy is to adjust the nominal exchange rate about in line with Argentina's rate of inflation, implying some real depreciation over time. The fact that a real effective appreciation, as measured by the information notice system index, has occurred reflects three factors other than the possible

^{1/} The operation of the information notice system is described in EBS/83/138 (7/6/83). The methodology employed in calculating the real effective exchange rate used in the system is set out in the Appendix in EBS/83/139 (7/7/83).

seasonal adjustment issue mentioned above. (1) The exchange rate adjustment in one month reflects price developments in the preceding month. Therefore, when there is a sharp acceleration in inflation, as there was in June, a real appreciation would be recorded. (2) In depreciating the peso in line with the rate of inflation, the emphasis has been on the relationship with the U.S. dollar, which in the period January-June appreciated relative to the currencies of Argentina's other trading partners. (3) The measure of inflation taken into account in adjustment of Argentina's exchange rate has been the wholesale price index, while for the information notice system, the standard index used is the consumer price index. Since January, wholesale prices in Argentina have risen somewhat more slowly than have consumer prices.

Available data suggest that at least through May the balance of payments objectives of the economic program were being met, and from mid-March to late June the differential between the parallel and official exchange rates narrowed substantially. However, there was a sharp increase in inflation in June, and a marked widening of the differential between the parallel and official exchange rates beginning in late June. In early July the authorities stepped up the monthly rate of depreciation from about 8 percent to 12 percent. Also, credit conditions were tightened and regulated interest rates were raised.

Staff Appraisal

The increase since January in the real effective rate as measured for the purpose of the information notice system has occurred despite the application of a policy, set forth in the financial program supported by a Fund stand-by arrangement, of tailoring exchange rate policy over the medium term to achievement of a balance of payments target and, in the short term, to depreciating the peso in line with the rate of inflation. The increase in the real effective rate reflects a lagged relationship between inflation and exchange rate adjustment as well as two developments that, during this period, worked in the same direction--the continuing effective appreciation of the U.S. dollar and the divergence between the rate of inflation recorded by the consumer price index and that recorded by the wholesale price index.

In a high inflation environment such as prevails in Argentina, the data may show shifts in relative prices to be large and volatile, and movements in any index of the real effective exchange rate must be interpreted with caution. In addition, the shifts in cost-price relationships that are sought by depreciations, such as the large one that took place in Argentina during the last two years, may result in a divergence between relative cost and relative price indicators, and thus may make it difficult to use real effective exchange rates based on the evolution of prices as an accurate indicator of a country's competitiveness. Nevertheless, given the importance for Argentina to

maintain its improved competitiveness, the possible erosion of competitiveness suggested by the movement of exchange rates and consumer prices should be examined.

Of course, the movement of a single indicator of competitiveness is not in itself sufficient to reassess exchange rate policy. The Argentine balance of payments performed well in the period through May, and the differential between the parallel and official exchange rates narrowed through late June. However, a sharp increase in the inflation rate occurred in June and a marked widening of the differential between the parallel and official exchange rates also began in late June. In response to these developments, the authorities have adjusted exchange rate and credit policies. The various aspects of policy, including exchange rate policy, will be reviewed in the normal course of discussions between the staff and the Argentine authorities regarding the implementation of Argentina's stabilization program.

Attachments (2)

Table: Argentina: Real Effective Exchange Rate and Related Series

(Indexes: 1980 = 100)

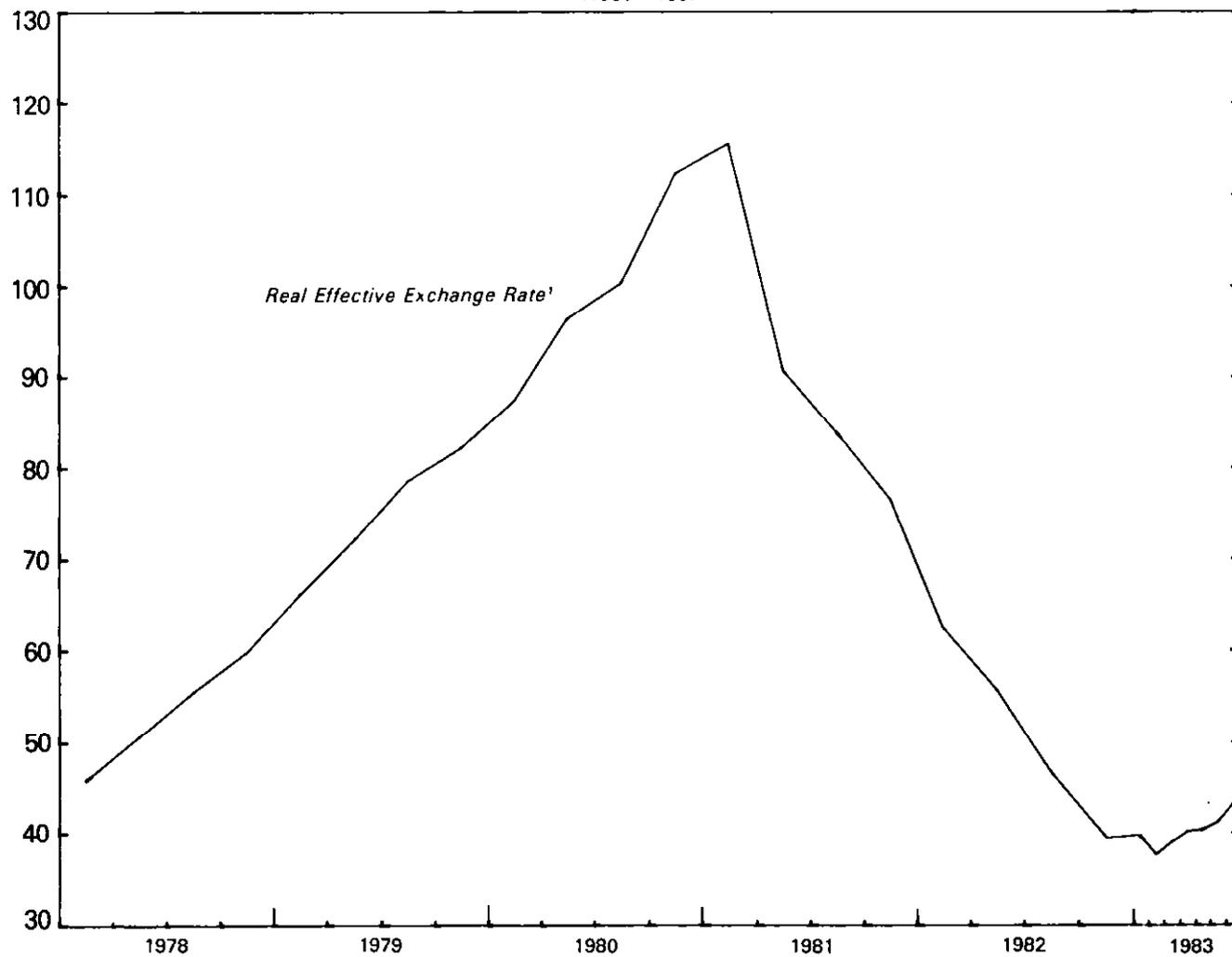
	Real Effective Exchange Rate <u>1/2/</u>	Nominal Effective Exchange Rate <u>1/</u>	Relative Consumer Prices (local currency) <u>2/</u>	Exchange Rate (U.S. dollars)	Consumer Price Index <u>2/</u> (seasonally adjusted)	Consumer Price Index (not seasonally adjusted)	Wholesale Price Index (not seasonally adjusted)
<u>Quarterly</u>							
1978							
I	45.85	257.45	17.9	277.48	12.8	12.9	16.0
II	50.65	222.22	22.8	238.99	16.8	16.8	20.2
III	55.62	202.21	27.6	222.78	20.8	20.6	24.3
IV	59.91	175.78	34.2	196.56	26.5	26.4	30.9
1979							
I	66.18	153.26	43.3	169.03	34.5	34.8	39.4
II	72.28	137.60	52.6	148.11	43.4	43.3	49.6
III	78.61	121.19	65.0	131.12	55.8	55.5	65.4
IV	82.24	112.41	73.2	118.32	65.7	65.7	73.6
1980							
I	87.45	106.65	82.0	108.70	77.1	77.8	82.2
II	96.33	101.34	95.2	101.53	93.2	92.3	94.1
III	100.27	95.89	104.6	96.52	106.2	105.9	106.2
IV	112.22	96.40	116.4	93.26	123.6	124.0	117.5
1981							
I	115.56	91.50	126.5	83.71	140.5	141.9	128.4
II	90.70	59.80	153.0	50.94	176.9	174.7	169.5
III	83.88	44.96	187.1	35.83	225.8	225.4	238.0
IV	76.54	35.04	219.1	28.18	274.6	276.0	302.5
1982							
I	62.36	23.25	268.5	17.87	347.4	351.1	401.0
II	55.65	18.32	304.6	13.53	408.5	401.7	498.2
III	46.69	11.45	414.1	8.03	576.9	576.6	849.3
IV	39.76	6.96	578.2	4.70	830.9	836.3	1,237.9
1983							
I	38.97	4.86	807.3	3.21	1,197.7	1,201.0	1,777.3
II	41.59	3.81	1,096.9	2.35	1,692.8	1,660.9	2,362.9
<u>Monthly</u>							
1983							
Jan. <u>3/</u>	37.58	5.24	717.9	3.56	1,052.3	1,071.5	1,574.6
Feb.	39.03	4.85	804.8	3.20	1,191.3	1,211.0	1,782.6
Mar.	40.28	4.48	899.2	2.86	1,349.4	1,347.4	1,974.8
Apr.	40.31	4.07	991.5	2.55	1,507.8	1,485.8	2,110.5
May	41.17	3.80	1,084.1	2.36	1,670.0	1,620.5	2,323.0
June	43.38	3.56	1,215.0	2.15	1,900.6	1,876.5	2,655.2
<u>Percentage change</u>							
Jan.-June	15.1	-32.1	69.2	-39.7	80.6	75.1	68.6

1/ Increases mean appreciation.

2/ Using seasonally adjusted price indexes.

3/ Date of latest consideration by Executive Board.

ARGENTINA
INFORMATION NOTICE SYSTEM INDEX OF REAL EFFECTIVE EXCHANGE RATE
(1980 = 100)



¹Trade weighted index of nominal exchange rates deflated by seasonally adjusted consumer prices, increase means real appreciation.