

**EXECUTIVE
BOARD
MEETING**

SM/16/300
Correction 1

November 8, 2016

To: Members of the Executive Board

From: The Secretary

Subject: **Argentina—Selected Issues**

Board Action:

The attached correction to SM/16/300 (10/26/16) has been provided by the staff:

Typographical Errors **Page 75**

Questions:

Mr. Cardarelli, WHD (ext. 38059)
Ms. Lusinyan, WHD (ext. 34898)

parallel market spread, which has de facto been eliminated, is not considered in the final specification.⁵

- For *interest rates*, we used LEBAC rates weighted by their maturity structure. Real interest rates are defined as the nominal interest rate deflated by the one-quarter-ahead annualized inflation.⁶

8. The key parameters of the model have been estimated using Bayesian methods to characterize the structure of the Argentine economy. The estimated parameters and Bayesian priors are presented in Table 1. The values of the key parameters are initially calibrated (i) factoring earlier findings in the literature (ii); to deliver steady state means and standard deviation of the macroeconomic variables that are close to their sample estimates; (iii) to result in plausible estimates of latent variables like the output and exchange rate gaps; and (iv) to deliver well-behaved impulse response functions. All parameters are then re-estimated with the calibrated parameters as priors with varying degree of certainty. The main results obtained are:

- *Inflation inertia.* The resulting model suggests a significant degree of backward-looking inertia in the inflation process. The point estimate of the parameter of the lagged CPI term in the Phillips curve is 0.67, very similar to what found for Argentina by D’Amato and Garegnani (2009) but higher than estimates in inflation targeting countries in Canales-Kriljenko and others (2009).⁷ [Box 1–Box 3 in the Staff Report](#) explores the empirical link between inflation inertia and that in wages and inflation expectations.
- *Exchange rate pass-through coefficient.* The coefficient of the real effective exchange rate on the Phillips curve is 0.1. This is similar to the levels estimated Canales-Kriljenko and others (2009) for Colombia, Mexico, and the European Union, but lower than that estimated for Chile, Brazil, and Peru.
- *Effect of output gap on inflation* The parameter of the output gap on the Phillips curve equation is nontrivial at 0.472. This is larger than the range of the estimates on the lagged (as opposed to the contemporary) output gap for individual Latin American inflation targeting countries (Canales-Kriljenko and others, 2009). For comparison, D’Amato and Garegnani (2009), using a different methodology, find a very small coefficient of the output gap on the Phillips curve of 0.01.
- *Effect of real interest rates on economic activity.* The parameter of the real interest rate on economic activity is relatively small (0.1). This low number may reflect the low level of financial intermediation in Argentina, partly due to the prevailing financial repression of the last decade.

⁵ Although excluding the parallel market rate from the specification could in principle bias the results under conventional econometric methods, the use of Bayesian priors and methods would tend to reduce this bias.

⁶ In particular, the natural logarithm of (1+nominal interest rate) less four times the one-quarter ahead difference in the natural logarithm of the price level.

⁷ In the BCRA model estimated by Elosegui and others (2007) with data covering the period 1993–2006, the weight of past inflation is slightly higher than the weight on future inflation.