



Argentina

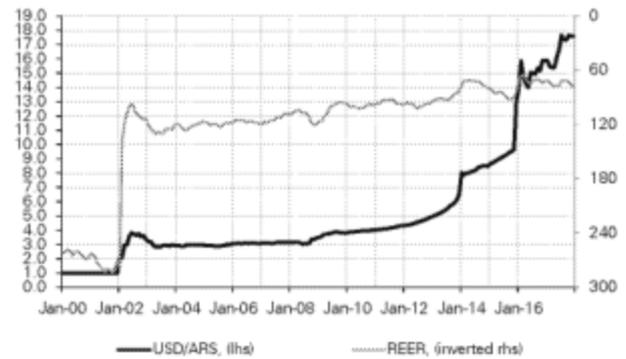
Argentine FX arrangements were plagued by monetary mismanagement and inflation throughout most of the twentieth century leading to periodic large devaluations. The Peso Ley replaced the Peso Moneda Nacional in 1970 at a rate of 100 to 1, which was itself replaced by the Peso Argentino at a rate of 10,000 to 1 in 1983. In 1985, this was again replaced by the Austral at a rate of 1,000 to 1, though this soon collapsed via hyperinflation. Beginning April 1st 1991, Argentina operated a currency board system with the Peso (converted from the Austral at 10,000 to 1) pegged to the dollar at the rate of one to one, every peso in principle backed by hard currency reserves. The "Convertibility Plan," was conceived to solve Argentina's chronic inflation problems, and throughout the first half of the 1990s the system underpinned an economic boom, with inflation declining to single digits. However, as the decade wore on, the real appreciation of the dollar placed the system under strain as REER became increasingly overvalued. The combination of persistent budget imbalances, negative terms of trade shocks, and inflexible monetary policy eroded credibility and culminated with the abandonment of the currency peg on January 6th, 2002.

Floating the currency led to a 70% devaluation of the Peso, taking it from one of the most overvalued to one of the most undervalued currencies in the world. Since then, the exchange rate has been tightly managed and capital flows strictly controlled. As the economy recovered from the 2002 crisis, inflation increased once again (albeit under-reported by the government since early 2007), undermining the competitiveness of the exchange rate. During the global crisis of 2008, the authorities faced the challenge of allowing the currency to depreciate but without triggering a sharp currency substitution. The Central Bank of Argentina (BCRA) embarked on a managed depreciation path, which by the middle of 2009 was successfully completed.

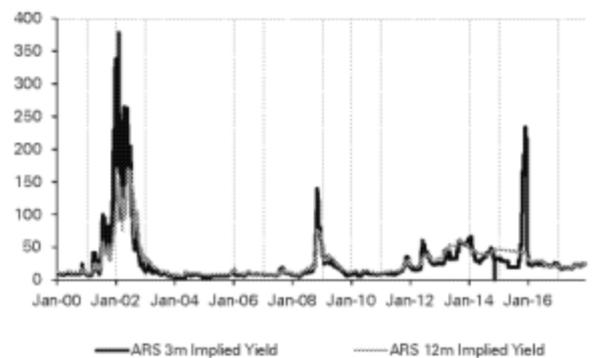
After 2010, the Central Bank followed a more gradual depreciation trend significantly below inflation. In order to stop capital flight and rein in the exchange rate, in November 2011 the government introduced several currency controls which lead to the development of a vast black market. In mid-2013 the path of depreciation accelerated in an attempt to account for an accumulated real appreciation of more than 30% since 2010. This was followed by a 15% depreciation in January 2014. Nonetheless, peso devaluation was not accompanied by the necessary tightening of fiscal and monetary policies, leading to inflation accelerating to 40% YoY (from 25% before). Consequently, the currency quickly became overvalued. The currency is not convertible, and most USD inflows are subject to a mandatory, unremunerated one-year deposit at the Central Bank. In November 2011, the government stepped up the restrictions to trade in the local currency market and forced some repatriation of funds (see below). In addition all types of USD hoarding were

prohibited and severe restrictions were imposed on capital outflows. Regulations will likely remain restrictive, negatively affecting liquidity in NDF and options markets.

USD/ARS spot and REER

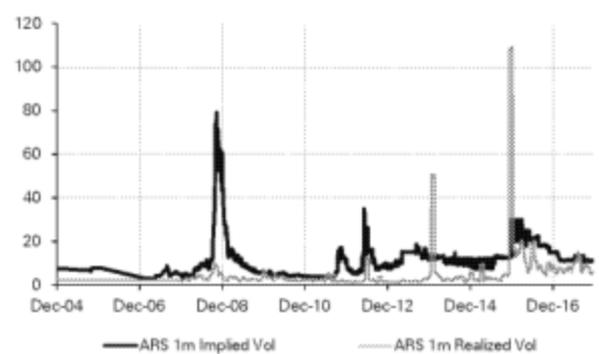


3M and 12M USD/ARS (offshore) NDF implied yield



Source: DB Global Markets Research, Bloomberg Finance LP, BIS

1M USD/ARS implied volatility and realized volatility



Source: Deutsche Bank

In December 2015, the new government led by President Mauricio Macri dismantled most of the FX controls introduced by the previous administration, including restrictions on imports of goods and services and profit remittances and the mandatory non-