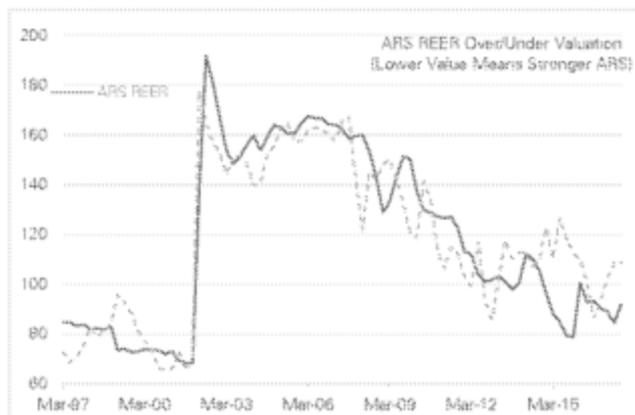




the Egyptian pound, for instance – the peso is already overvalued according to our estimation (chart below). Therefore, while in Egypt monetary authorities can afford to keep the pound stable for months, Argentina’s central bank needs to strike a balance between anchoring inflation expectations and preventing excessive overvaluation.

The ARS moves ahead of fundamentals



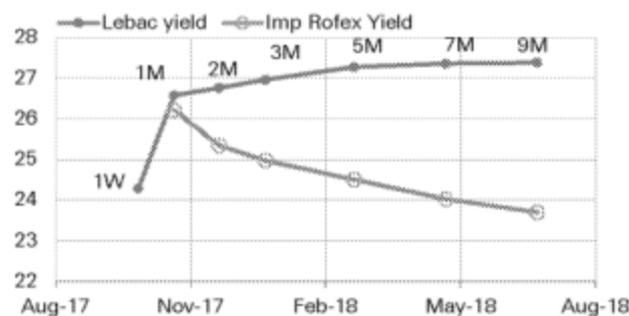
Source: Deutsche Bank

This tug-of-war has resulted in USD/ARS following a “step-function” ascent – with jumps followed by stability – thus boding for tactically managing longs (carry based strategies)

The choice of instrument in the short-end is also important given wide dispersion in valuations. LEBACs are the cleanest instruments to express monetary policy views, but they are also short and the least accessible. Fixed-rate BOTEs and floating BOCANs and BOPOMs are accessible, but bear in mind that they also differ in liquidity and fixings so that comparing these instruments has obvious limitations.

From a macro standpoint, LEBACs price a small likelihood of further tightening and low supply risk – thus favoring floaters, as we discuss in more details shortly. The chart bellows shows that the term-structure is flat, while we see room for further tightening. Also, the LEBACs have been used not only as a conduit to implement monetary policy but also for sterilization purposes. Widening CAD and slow reduction in nominal deficits bode for pent-up supply of LEBACs and thus upside risk for these short-end fixed instruments.

LEBACs vs. ROFEX: Hovering around the recent highs

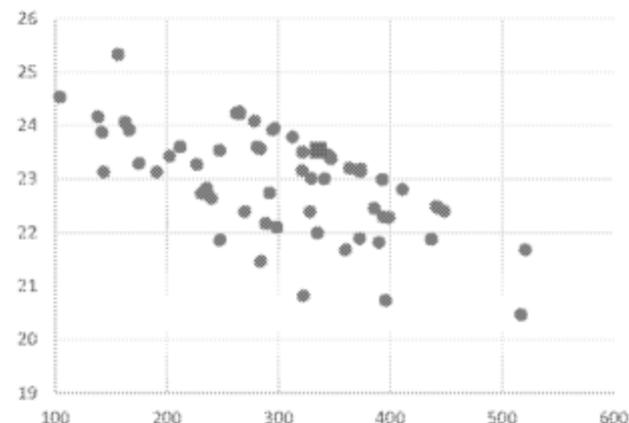


Source: Deutsche Bank, Bloomberg

Implied yields also seem too low. The chart below shows that the 7M point for example offers almost 340bp of pick up from a hold to maturity perspective. This wide spread suggest that tactical hedges for the peso’s “step-function” behavior are relatively inexpensive – a result that extends to floaters.

Implied yields: Relatively low bar for tactical hedges

Lebac - FX Impl. 7M vs Impl. 7M; % vs. bp



Source: Deutsche Bank

Fixed or floating rates? A look into valuations

We prefer floaters to fixed rate instruments on our macro view and valuation, although the latter is clouded by market segmentation. We use LEBACs as a building ground for valuation despite its limitations because: 1) They are the main instrument to manage local liquidity; 2) They ultimately affect the private floating rate used to fix the BOCANs; and 3) The repo rate used to fix the BOPOM 20s moves in line with the 35-day LEBAC yield

Since the LEBAC curve extends to only 9 months we also build on BOTEs in pricing two scenarios for short-