Monetary Policy: Assessment and Outlook

The global growth outlook for 2020 has worsened since the latest IPOM was published. On the basis of data about the early impact of the COVID-19 pandemic that lasted longer than expected, forecasts predict that the current recession would hit economy three times worse than the 2008-2009 global financial crisis. Signs of recovery have already emerged. However, there is still a high level of uncertainty around a number of factors: the evolution of the pandemic; the effectiveness of fiscal and monetary policies followed to mitigate the effects of the crisis in the medium and long term; and a potential disconnection between international financial markets with ample liquidity and the still anemic global real economy.

Argentina began the second phase of the COVID-19 economic cycle during the second quarter of 2020, when the first signs of recovery emerged after social isolation measures started to be eased gradually, as it had been forecast in the previous IPOM. Against the backdrop of a plummet in international trade flows and Argentine exports falling by 11% s.a. since March, the incipient recovery was mainly driven by the domestic market demand—boosted by carefully coordinated fiscal and monetary policy efforts. Economic activity indicators show that economy recovered, though at a different pace across regions, since the height of the crisis in April. This is explained by the fact that activities were unevenly resumed on account of the asymmetric epidemiological evolution of the pandemic. In the future, the strength of recovery will entirely depend on the evolution of the pandemic; the ability to reactivate private spending conditional on households' and businesses' financial situation; and the effectiveness of government policies aimed at safeguarding the productive fabric, compensating for households' lack of income, and speeding up recovery based on domestic demand dynamics.

The lower inflation dynamics that have been observed since early 2020 consolidated ever since. The managed float policy intended to dampen exchange rate volatility was at the core of this process. During the second quarter, the unprecedented suspension of activities along with a decline in household spending helped to overcome inflationary inertia. The government had a key role in protecting household purchasing power by implementing a program on maximum benchmark prices (called *Precios Máximos y Cuidados*). In the second half of the year, the average monthly inflation rate will be slightly higher than the second quarter as a result of readjustments to benchmark prices associated with the recovery in the price of services upon the resumption of activities. Yet, inflation will remain well below the levels observed in 2019. The postponement of collective bargaining and utility rates adjustments also contributed to lower price dynamics during these months. An orderly readjustment of benchmark prices will be central to next year's consolidated slowdown in inflation.

The pandemic economic emergency called for extraordinary measures aimed at supporting households and businesses. The main fiscal measures—which enabled the government to meet 70% of primary expenditure in the second quarter— were intended to pay Emergency Family Bonuses (IFEs); to provide food cards, benefits under the Emergency Assistance for Work and Production Program (ATP), and unemployment allowances; to freeze utility rates; to make additional payments to essential workers; to meet expenditure on health supplies and capital goods; and to make transfers to provinces. In particular, the Ministry of Productive Development estimated that the IFE prevented 2.8 million people from falling into poverty, and 1.4 million from being pushed into destitution. The result of these measures together with the exemption on the collection of employers' contributions and interest on loans granted to ANSeS beneficiaries accounted for around 3.3% of GDP in June and would exceed 4 points by the end of this year. The BCRA played a key role in financing the National Government's fiscal stimulus package during the emergency. However, financing options for the Treasury narrowed on different grounds: considerable difficulty in accessing financial markets within the framework of the external debt restructuring process; reconstruction of debt markets in pesos; and limited chances to get fresh funds from multilateral lending agencies.

The BCRA strove for relieving businesses and households from their financial burden, protecting domestic currency savings, and creating the conditions for the financial system to support the private sector making allowances for the economic emergency. The implementation of these measures involved making extensive use of the monetary policy instruments, such as the regulation of lending and borrowing interest rates to stimulate both credit and savings; and minimum cash requirements—a prudential tool that contributed to achieving major objectives in the current situation.

First, the measures aimed at promoting credit unleashed a bank financing countercyclical response, with loans to the productive sector—in particular, subsidized interest rate credit lines for MSMEs—coming to the fore. These loans were mainly channeled to MSMEs and Health Service Providers (24%). This credit line, primarily intended to meet MSMEs' working capital needs, accrued $369.348 billion funding since the beginning of the lockdown—well above $220 billion, the amount that was originally expected. In turn, the MiPyMEs Plus line, intended for companies with no access to bank financing, granted $2.45 billion since its implementation. The increase of these credit lines virtually accounted for the growth of all business credit lines (over 50% since the beginning of the lockdown) and, by late June, stood for over a third of the productive financing stock, and 16% of total loans to the private sector. Thus, business credit lines went from a virtual 50% y.o.y. contraction at the end of 2019 to a record raise in real terms. Credit card financing at 0% rate was also granted to members of the simplified tax regime and self-employed workers. Since its creation, the credit lines granted amount to $61.014 billion, out of which $53.126 billion were credited, explaining two-thirds of the credit card balance growth since early May. The growth of credit card financing was further explained by the expansion of the "Ahora 12" program to include more goods and services at a maximum 43% APR.

Second, early-payment UVA time deposits and minimum interest rates for time deposits, together with a moderate price growth, ensured a positive real return for savings in domestic currency. As a result, time deposits gained momentum, recording historically high growth rates. In particular, these deposits grew 9.4% in real terms in June, the highest figure recorded since the exit of the currency board regime.

Argentina's financial system has a high level of liquidity and solvency driven by the macro and micro-prudential policies followed over the past two decades. Thus, it is in a better position to deal with the COVID-19 crisis. It has also played a crucial role in mitigating the effects of the crisis by readjusting the BCRA's instruments within the framework of economic and social emergency triggered by the pandemic.

By late 2019, the BCRA developed several policy guidelines[1] focused on the paths of interest rates and exchange rates. In a context of a restrained exchange rate volatility favored by a managed float regime and current regulations on capital and financial accounts, the BCRA has let the LELIQ interest rate go down from 63% to 38% APR (from 87.1% to 45.4% EAR) on a gradual basis since early March. Following this strategy, the BCRA weathered the pandemic crisis by setting an interest rate suitable enough to relieve households and businesses from their financial burden. The BCRA holds that real interest rates should preserve the economy's financial and external stability, and that they go hand in hand with production financing and a longer-term yield curve, thus favoring domestic currency savings.

Finally, the limited exchange rate volatility and the prudential use of international reserves have also been at the heart of the BCRA's monetary policy. In the last few months, the sources of foreign currency financing have been meager due to a high level of financial uncertainty fueled by both the effects of the pandemic on emerging markets and the restructuring process of the public debt under foreign law. Existing exchange market regulations and the foreign exchange managed float regime allowed to mitigate exchange rate volatility, thus avoiding its adverse effects on domestic prices, economic activity, and financial stability. Going forward, debt payments will contribute towards handling foreign affairs. In this sense, the agreement reached with the three groups of private creditors on the public debt under foreign law will enable us to follow a fiscal and external path that may speed up a process of sustainable growth. Much of this year's financial uncertainty will be dispelled in the coming months, and the domestic currency debt market may become deeper. The new maturity profile together with an increased external financing capacity of the private sector will help to reduce net foreign exchange demand in the exchange market and to make room for the re-composition of imports associated with the expansion of production and consumption in line with the foreign trade balance.

Public debt agreements and economic recovery are significant developments, but there are still important challenges ahead. Argentina's economic situation calls for an active central bank that promotes employment and economic development with social equity, without losing sight of monetary and financial stability. In this context, the BCRA will strive for streamlining the process of economic recovery by encouraging productive credit, especially to MSMEs—the main driving force behind employment in Argentina.

Monetary policy management during the COVID-19 emergency period has required a major expansion of liquidity. The increased demand for money has contributed to sterilize a significant portion of resources from the economy, a trend that will be reinforced once the economic recovery

1 See "Guidelines for Monetary Policy in a Macroeconomic Transition Period".

consolidates. The level of monetization of the Argentine economy was, before the pandemic, near historical records low, and is expected to reach fair values at the end of the year. The BCRA will deploy all its tools in the face of any excess liquidity that may arise in the coming months. So far, the BCRA has mostly used LELIQs and repos, with an average return of 33% APR—the first 7 months of the year being comparable to the same period in 2019, and significantly lower in real terms.