1. Monetary Policy: Assessment and Outlook

The global economy continued undergoing the COVID-19 sanitary crisis, marked by the onset of a new wave caused by the Delta variant, which is more contagious and probably more aggressive than the other variants in circulation. Nevertheless, the economic activity has kept its pace with sharp differences across countries due to inequalities in the vaccination campaign pace and in the monetary and fiscal leeway to continue implementing stimulus measures. In this context, during the second quarter of the year, the inflation pace accelerated worldwide, driven by the increase in commodity prices and the resumption of activities. The potential measures that might be adopted by the central banks of advanced countries in the face of this inflationary upsurge could impact on global financial conditions, with adverse implications for emerging economies.

In Argentina, the economic activity has shown signs of recovery in June, after the curb observed in April and May due to the onset of the second wave of COVID-19 infections. By mid-March, the National Government, together with the provincial authorities, adopted a series of measures to contain the new outbreak, which were specifically adjusted to each region of the country based on their epidemiological situation. On this occasion, the duration of the measures was more limited because of the progress made in the vaccination campaign and the improvements achieved for the health-care system. In order to contain the economic and social effects of this second wave, the Central Bank and the National Government focused their stimulus measures on the most vulnerable sectors of the population and on the support to companies located in the hardest-hit jurisdictions. The regularization of the economy is expected to continue in the next few months even though, as it is observed in other countries, the circulation of new variants of the virus may postpone such process.

Regarding prices, and as already stated in the previous Monetary Policy Report (IPOM), the monthly inflation rate started to decelerate gradually, given the lesser impact of temporary factors that led to a faster pace in terms of price increases by the end of last year. These factors included the rise in the international prices of food products and key inputs for the manufacturing value chains, the momentum observed in the price of beef meat and some seasonal goods, and the recomposition of profitability margins, especially in the sectors that have been hardest hit by the pandemic, once the economy started to reactivate. This trend of gradual and sustained reduction of inflation continued in July, with a 3% rise in headline inflation (CPI) and 3.1% increase in core inflation, which have been the lowest monthly rises since September 2020. In turn, the Domestic Wholesale Price Index (IPIM), which had already shown a slowdown in its average monthly expansion pace to 3.7% during the second quarter (-1.5 p.p. against the first quarter), slowed down more sharply in July and posted a rise of 2.2% against June. It is estimated that the monthly deceleration of prices against the previous quarter will continue in the next few months and contribute to a decline in the year-on-year inflation growth rates towards the end of the year.

In this respect, the BCRA will continue with its managed exchange rate policy, so that the exchange momentum may help consolidate a gradual process of reduction in the inflation rate. On a supplementary basis, the monetary policy will continue to be focused on absorbing the countercyclical efforts in order to preserve the monetary and financial balance, ensuring the conditions required to sustain a gradual process of inflation reduction. These macroeconomic policies will keep on supporting other specific measures promoted by the National Government, in terms of both income policies and regulation of some markets characterized by non-competitive price formation.

With a more limited fiscal deficit, largely funded by the market, the primary monetary issue related to the public sector in the first seven months of the year stood at levels similar to those of previous years, except for 2020. In June, and in order to continue contributing to the development of the domestic capital markets, the BCRA authorized financial institutions to satisfy with Treasury bonds in pesos the portion of the minimum reserve requirements that, until May, were remunerated with LELIQs. This regulatory change gave rise to a shift in the composition of bank liquidity since around 20% of the regulatory requirement that was previously satisfied with LELIQs is now satisfied with National Treasury Bonds. In turn, in order to continue deepening liquidity in the capital markets, the BCRA has started to operate in the sovereign bonds futures market.

The main factor behind the expansion of the monetary base during the first half of the year was the purchase of foreign currencies by the BCRA in the foreign exchange market. The management of this market has helped to strengthen the stock of International Reserves. From December 2020 to August 2021 (with data as of August 19), there were net purchases for US$8 billion. A higher external surplus has simultaneously served to adapt the exchange rate adjustment pace in order to contribute to a deceleration in the domestic prices increase pace.

In this context, towards the end of the second quarter of the year, means of payment started to expand once again in real terms. The transfers made by the public sector to the most vulnerable segments as well as the recovery of real wages impacted on this evolution. In order to face a higher level of spending on wages and the payment of tax obligations, legal persons reduced their position in investment assets in pesos, which all together contributed to a higher demand for liquidity.

The credit policy continued to be focused on the sectors hardest hit by the pandemic and on supporting investment projects. The main instrument used by the BCRA was the Credit Line for Productive Investment (LFIP), which was designed to provide credit for productive purposes to micro, small and medium-sized enterprises (MSMEs) under favorable conditions. As from its implementation and according to data as of July 31, the disbursements via the LFIP amounted to $801 billion. Thus, in the second quarter of the year, the average monthly nominal growth of these loans reached 19%. Recently, the BCRA decided to expand the "Credit Line for Investment Projects", at a 30% nominal annual percentage rate, to all companies, regardless of their size, that make investments intended to expand the productive capacity of poultry and pork meat. These sectors have a potential margin to increase their production and contribute to the diversification of the meat consumption basket and the increase of net exports.

On a supplementary basis, other measures were implemented to improve the level of bank lending to the private sector. A deferral of unpaid installments (except for financing with credit cards) was granted to the beneficiaries of the Productive Recovery Program II. In addition, the National Government extended the "Ahora 12" Program until January 31, 2022, with some changes in order to promote consumption and invigorate financing with credit cards. Lastly, the National Government announced that, as from late August, there will be credit available for over one million workers under the Simplified Tax Regime, who will be entitled to request an amount of up to $150,000, according to their category, and pay the loan back in 12 installments with zero interest rate, after a six-month grace period.

The BCRA is in a robust position to face eventual episodes of higher financial volatility which, in Argentina, have traditionally coincided with electoral periods. In the last nine months, the monetary authority has rebuilt its stocks and improved the exchange rate regulation, thus increasing its fire power to preserve exchange stability. In fact, since early December 2020, when the International Reserves reached a minimum floor of

US$38.6 billion, the BCRA has accumulated reserves for an amount of US$3.4 billion. This evolution in the rebuilding of stocks, together with the receipt of the Special Drawing Rights (SDRs) allocated by the International Monetary Fund (IMF) in order to mitigate the impact of the pandemic for a total of US$4.3 billion, has resulted in a current stock of International Reserves of around US$46 billion.

Likewise, the BCRA has a remarkable room for intervention in the dollar futures market, which serves to contain any distortion that might appear in terms of depreciation and interest rate expectations resulting from these contracts. Lastly, the improvement achieved in exchange rate regulations ensures the normal operation of the foreign exchange market, preventing the recurrence of the exchange tension episodes observed during 2020 amidst the pandemic.

In a context still marked by the effects of the COVID-19 pandemic, the BCRA will continue to adopt a monetary policy that may lay the foundations for economic development with social equity, in addition to preserving monetary and financial stability.