

Monetary Policy: Assessment and Outlook

In the last few months, the global economic activity slowed down with a resulting increase in the risks of recession. Inflation continued to stand at record-high levels if compared to the rates of the last decades despite the contractionary bias of the monetary policy in most countries. In this context of reduced economic momentum, the prices of metals and agricultural commodities resumed the levels they had before the beginning of the armed conflict in Ukraine. Financial conditions started to be more adverse for developing countries: the US dollar tended to appreciate, accompanied by an increase in the return on advanced countries' financial assets and a rise in the risk differential in emerging countries, resulting in higher external financing costs for the latter. Towards the future, the outlook will continue to depend on the degree of impact of contractionary monetary policies on the global economic activity and financial stability, and on the potential of the Chinese Zero-COVID Policy to alter the regular operation of the global value chains.

The Argentine economic activity continued to expand during the second quarter. Despite the impact of a reduced harvest due to the drought that affected agricultural production, GDP grew 1% seasonally-adjusted. Even though the leading indicators corresponding to July and August are signaling a growth curb during the third quarter, the economic activity is expected to resume its growth path in the last part of this year and the beginning of the next one, within a context of lower financial volatility and better exchange rate stability. In this macroeconomic context, the Central Bank of Argentina (BCRA) has continued to focus its credit policy on productive development. In this respect, the "Credit Line for Productive Investment (LFIP)" is still the main tool used to grant loans for productive purposes to micro, small and medium-sized enterprises (MSMEs), under favorable conditions. From its implementation and up to August 2022, the loans granted under the LFIP have accumulated disbursements for around ARS\$2.87 trillion. By the end of August, approximately 300,000 enterprises had received loans under the LFIP. As from the renewal of this credit line, with data available as of July, the average stock of disbursements stood at ARS875 billion, accounting for nearly 38% of commercial loans and 16% of total credit provided to the private sector. It is worth mentioning that this credit line was recently extended until March 31, 2023, under conditions similar to those of the previous renewal.

The incipient downward trend in monthly inflation rates observed in May and June was interrupted in July, when prices went up to 7.4% over the month (+2.1 p.p. against June). In this respect, there were price increases in many goods and services simultaneously, with a diffusion and coordination level that usually occurs during episodes of leaps in the official exchange rate. This inflation acceleration occurred in a context of intense financial volatility resulting in a heightened exchange uncertainty and, consequently, in rising inflation expectations. The year-on-year (y.o.y.) inflation rate reached 78.5% in August.

Against this backdrop, the BCRA adopted a series of measures to curb financial volatility and contain inflation. In the first place, and in line with the policies articulated last December in the "Objectives and Plans Report for 2022", the reference interest rates were raised on several occasions, thus speeding up the monetary policy regularization to converge to positive interest rates in real terms, with a view to preserving exchange and financial stability. Thus, the interest rate on 28-day LELIQs has stood at a nominal annual percentage rate (APR) of 75% (effective annual percentage rate of 107.3%), resulting in an increase of 26 p.p. since the previous report. Likewise, the BCRA also intended to ensure a positive return in real terms on investments in domestic currency, thus reinforcing the monetary policy transmission channel via an increase in the minimum regulated interest rates on time deposits. As from the end of June, the interest rate floor for time deposits from natural persons up to ARS10 million went up 22 p.p. to a nominal annual percentage rate of 75%

(effective annual percentage rate of 107.1%) while, for the remaining time deposits, the minimum guaranteed rate rose 16.5 p.p. to a nominal annual percentage rate of 66.5% (effective annual percentage rate of 91.1%).

It is worth pointing out that in economies like that of Argentina, with a relatively small credit channel, the interest rate rise mainly serves to encourage saving in pesos. Its anti-inflationary effect largely lies in contributing to exchange and financial stability, and this measure needs to be supplemented by other economic policy instruments in order to reduce inflation inertia.

In parallel, the BCRA also sought to lessen financial volatility using its intervention capacity through open market operations, and endorsed its commitment to intervene on the yield curve of the public debt in domestic currency. As from July, the BCRA decided to participate in the secondary market of National Sovereign Bonds with a residual term over 15 days making purchases at rates similar to the cut-off rates of the latest auctions plus a 2% maximum spread. In addition, the BCRA reinforced its coordination efforts with the National Ministry of Economy to ensure that the monetary authority's interest rate structure may exhibit reasonable spreads with the National Treasury Bills. The BCRA is seeking to gradually converge, in the medium term, towards an economic liquidity management based on open market operations (OMA) with Treasury Bills and other short-term instruments denominated in domestic currency. This mechanism is similar to the one used by other countries and turns out to be a convenient alternative to reduce the monetary policy's quasi-fiscal cost. In order to achieve this goal, the domestic capital market must be increasingly relevant in the financing of economic players, from both the public and the private sectors.

In the foreign exchange front, the BCRA continued gauging the change rate of the nominal exchange rate so that it may be consistent with domestic inflation, for the purpose of keeping adequate levels of external competitiveness. This objective was supplemented by an improvement in the current regulatory framework for the exchange market, seeking to promote an efficient foreign currency allocation. One of the most relevant measures adopted to encourage the inflow of foreign currency is the policy on the sale of soybean production, under the recently implemented "Export Increase Program" which promotes the settlement of soybean and by-products exports from September 5 to September 30 on the basis of an exchange rate of ARS200 per dollar. Under this mechanism, the oilseeds and grains sector had settled USD5.3 billion by the closing date of this report. In terms of foreign currency demand, the validity of the exchange rate regulations was extended for the sake of stability, while exceptions and special regulatory regimes were introduced for the payment of imports related to some productive activities, for the purpose of responding to the extraordinary need for foreign currency to pay energy imports, among other measures.

After the recent agreement reached by the IMF and the Argentine authorities at technical level on the second review of the Extended Fund Facility Arrangement, the only pending step by the closing date of this report was the final approval by the Executive Board of this multilateral financial institution. The review included an update of the domestic macroeconomic performance vis-à-vis an adverse international context, while keeping the existing primary deficit objectives of 2.5 % of GDP in 2022 and 1.9 % of GDP in 2023, and the reserve accumulation goals for the 2022-2023 period for an accumulated amount of USD9.8 billion. In turn, the monetary policy framework being implemented by the BCRA since early 2022 was endorsed in the review, focusing on an interest rate policy that may ensure nominal returns in line with the inflation rate and an official exchange rate evolution that may help preserve the Argentine economy's external competitiveness levels. Likewise, a structural agenda has been consolidated in order to include measures to strengthen the BCRA's balance sheet, design a road map aimed at the gradual easing of exchange rate controls, and encompass other aspects of the Federal Government's policy such as combatting fiscal evasion and money laundering, as well as promoting information exchange and international cooperation mechanisms.

After the monetary policy interest rate rise, the successful swap transaction of short-term public debt instruments, the initiatives aimed at consolidating the reduction process in the fiscal deficit and monetary financing and the new agreements on prices, both the Federal Government and the BCRA will continue adopting measures to reduce inflation. In this respect, the BCRA will manage its monetary policy by adjusting the interest rates to sustain their positive sign in real terms and will not provide net transitory advances to the National Treasury during the rest of the year, so that they may stand below the target committed with the IMF. The monetary authority will also manage liquidity to preserve monetary equilibrium and will also keep the crawling peg exchange scheme devoted to preserve external competitiveness.