Monetary Policy: Assessment and Outlook

The global economic activity continued to slow down in recent months and, at world level, growth forecasts for next year were revised downward once again. This occurred in a context where a persistently high inflation trend forced the central banks of advanced economies to implement the deepest monetary policy contractionary cycle since the global financial crisis of 2008/2009. Even though the financial conditions improved on the margin for developing countries, there is still a largely adverse context characterized by high interest rates and net capital outflows.

In Argentina, the economic activity continued to expand during the third quarter, at a higher rate than in previous quarters. From the standpoint of demand, private Consumption showed a marked momentum, while investment stood at around the maximum levels of 2017. However, the leading activity indicators for the fourth quarter are anticipating that growth is coming to a halt. This evolution will reflect, in part, the effect of the drought that impacted adversely on the winter crop in the last months of the year and it raises initial conditionalities on the result of the summer crop next year. Despite these factors, the Argentine economy would have a yearly growth rate over 5% in 2022, largely exceeding the forecasts made at the beginning of the year. A lower growth rate (around 2%) is expected for 2023.

The monthly inflation rate has gone down gradually since September and stood at 4.9% in November, the lowest level since February 2022. The reduction in the inflation rate was mainly due to the measures adopted by the Federal Government and the Central Bank of Argentina (BCRA) to curb the price acceleration observed in the first part of the third quarter. In particular, the BCRA raised the monetary policy interest rate on several occasions so that it may have a positive sign in real terms, thus contributing to foster the demand for assets denominated in pesos and favoring exchange rate stability. In turn, the Ministry of Economy implemented some policies aimed at consolidating the primary fiscal deficit reduction process and at mitigating the needs for monetary financing; in addition, the Ministry has also encouraged export settlement so as to strengthen international reserves, and reached agreements on benchmark prices for some sets of goods and services. These agreements include the so-called “Fair Prices” Program (*Programa Precios Justos*), launched in mid-November. Core inflation is expected to continue to go down gradually in the next few months within a context still characterized by high inflation expectations but favored by a lower momentum in international commodity prices and a recovery of wages which is gradual for the moment and, therefore, contributes to reduce inflation inertia.

In the context of the significant deceleration of the inflation rate in November, the BCRA decided to keep the monetary policy interest rate unchanged for the purpose of consolidating an environment of positive interest rates in real terms that may favor financial and exchange stability, and of reinforcing the trend towards a gradual inflation deceleration in the medium term. Thus, the interest rate of 28-day LELIQs as well as the regulated interest rate floor for time deposits from natural persons up to ARS10 million continued to stand at a nominal annual percentage rate (APR) of 75% (effective annual percentage rate of 107%). The interest rate of the remaining time deposits has continued to stand at a minimum guaranteed nominal APR of 66.5% (effective APR of 91%). It is worth pointing out that in economies like that of Argentina, with a relatively small credit channel, the increase in the interest rate 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.

Other policies adopted by the BCRA also contributed to preserve financial and exchange stability. On the one hand, the monetary authority continued using its intervention capacity through open market operations, in order to promote greater liquidity, depth and transparency in the sovereign debt markets. On the other hand, in the foreign exchange front, the BCRA continued gauging the change rate of the nominal exchange rate so that it may be consistent with the domestic inflation rate, for the purpose of keeping adequate levels of external competitiveness and encouraging the accumulation of reserves. In turn, this objective was supplemented by a constant improvement in the current regulatory framework for the exchange market. Equally relevant was the creation of the "Export Increase Program" that has allowed the soybean sector to settle currencies at an exceptional and temporary exchange rate, which increased International Reserves by USD5 billion during September and other USD1.2 billion in a second stage of the program from late November to the closing date of this Report.

The agreement reached by the IMF and the Argentine authorities at technical level on the third review of the Extended Fund Facility Arrangement, and its further approval by the Executive Board of this multilateral financial institution, consolidates the monetary policy framework being implemented by the BCRA, focused on an interest rate policy that may help preserve the savings of households and companies as well as an official exchange rate evolution that may serve to sustain the Argentine economy's external competitiveness levels. The framework of the agreement has allowed for keeping the fiscal deficit and Treasury financing objectives, as well as the reserve accumulation goals for the 2022-2023 two-year period. Likewise, a structural agenda has been consolidated in order to include measures to strengthen the BCRA's balance sheet and design a road map aimed at the gradual and conditional easing of exchange rate controls, among other aspects of the Federal Government's policy.

The BCRA will continue gauging the policies intended to consolidate the inflation reduction process. To this effect, it will keep on monitoring the macroeconomic situation, paying special attention to the past and future evolution of headline inflation, the sovereign debt market and the exchange rate market, especially in an electoral year when a higher volatility in the financial markets is usually observed. Likewise, it will keep a prudent management of monetary aggregates, by sterilizing eventual liquidity surpluses with its monetary regulation instruments, so as to preserve monetary equilibrium.

In this respect, the evolution of remunerated liabilities in recent years was the counterpart of the policies implemented by the BCRA to provide assistance to the National Treasury in the face of the COVID-19 pandemic, stabilize the sovereign debt market upon episodes of excessive financial volatility, strengthen international reserves and promote better returns for depositors, which contributed to lessen the pressures on the exchange market and strengthen the demand for assets denominated in pesos. Despite all these changes, the ratio between total monetary liabilities (Monetary Base plus Remunerated Liabilities) and GDP stood at 13.7% in November, 5.3 percentage points (p.p.) below the maximum level reached in 2018 and at a record similar to that observed between 2004 and 2015.

In the medium term, the sustained growth of the economic activity and the moderation of the inflation rate will result in a higher demand for real money balances. In this context, the efforts for monetary sterilization are expected to gradually decrease. This will favor the conditions under which the demand for Monetary Base will be provided by interest associated with remunerated liabilities of the BCRA and, potentially, by a reduction in the stock of such liabilities.