Monetary Policy: Assessment and Outlook

The Argentine economy faces a critical macroeconomic situation marked by extremely high inflation records and a deep and persistent recession, which has resulted in marked levels of unemployment, precariousness, and poverty. In turn, foreign currency shortage has significantly undermined the external sector which, as has happened in the past, seriously constraints its aggregate performance.

This is a renewed signal of external restriction that stemmed from the retraction of international commodity prices by mid-last decade, which had been caused by flaws in industrial and technological policies, and worldwide slowdown in economy and trade. These restrictions on commercial foreign currency flows have been exacerbated by a loss of access to voluntary lending and renewed domestic capital flight, given the vulnerability unleashed by an external debt process that was clearly unsustainable.

The inflation rate has followed the same path, soaring in the same period to accelerate significantly in the last two years of the former administration due to a number of mistakes in diagnosis and policy design—which tended to underestimate the difficulties in keeping inflation low on a sustained basis drawing on structural factors with evident inertial components. This misconception led the former administration to address the issue exclusively through monetary policy tools. Based on the hypothesis of excess supply of foreign financing in the continuum, they also made the mistake of fully deregulating the foreign exchange market and opening up financing unrestrictedly. In addition, a biased economic vision and an excessively “supply-oriented” conception caused national and provincial revenue collections to fall, thus deteriorating the fiscal position.

In this way, monetary, financial, and fiscal policies turned out to be inconsistent, entailing a severe balance of payments crisis, marked depreciation of the domestic currency, and the consequent deepening of recession and acceleration of inflation, with a strong impact on economy and society as well.

By the end of the former administration’s term, the National Executive branch adopted, though belatedly, a series of measures aimed at restricting the access to the foreign exchange market to mitigate the crisis and arrest the deterioration of the balance of payments. In addition, local debt was compulsively rescheduled, while the fiscal deficit (which could no longer be financed with external debt) began to be funded with monetary issuance.

In this context, the current National Government adopted a series of social, productive, regulatory, and fiscal measures aimed at countering the most dramatic effects of the crisis and stabilizing macroeconomy as a basis for redefining policy priorities to lay the foundations for sustained economic development. These measures are hand-in-hand with the Law on Social Solidarity and Productive Reactivation (Law 27541), which provides that conditions should be created to ensure the sustainability of the public debt, with an emphasis on social welfare by implementing progressive tax schemes. Likewise, they seek to get the economy back on its feet by strengthening the income of the most vulnerable sectors—so that they can reach their consumption levels— and easing SMEs’ tax debts.

As regards the regulatory framework, foreign currency proceeds from exports must be exchanged in the local foreign exchange market, and the build-up of foreign assets out of local resources is restricted. Simultaneously, a tax was levied on the purchase of foreign currency for saving purposes and the payment of tourist services and trips abroad.

Fiscal measures mentioned above and the broad tax moratorium for SMEs are supplemented by the following actions: an increase in export duties, changes in employer's social security contributions and corporate income tax, reorientation of consumption taxes, reform of property tax and statistical fee.

Within the framework of the Argentine Commitment to Development and Solidarity recently signed by representatives of companies, unions and social organizations, the National Government has implemented dynamic income policies—such as a prices agreement under the Preserved Prices Program (Programa Precios Cuidados), and frozen public service rates for up to 180 days, until the current schemes are fully renegotiated. Along these lines, the economic situation of the most vulnerable social sectors has been eased by granting fixed amount increases in wages and social security benefits among others provided under the National Program on Food and Nutrition Security.

In the context of the economic and social emergency described above, and the critical access to the voluntary foreign debt market, the BCRA deems it fit to exceptionally assist the Treasury to make foreign debt payments where strictly necessary and under reasonable limits that may enable to strike a balance of financing in the local monetary market.

Similarly, the Government is committed to reestablishing the sustainability of the public debt. Therefore, the National Executive Branch has deemed it appropriate to put forward the submission of the National Budget for the fiscal year. In such circumstances, a monetary policy strategy with specific objectives on the expansion of aggregates or inflation is not likely to be developed until the National Budget be submitted.

Taking into account these constraints, but in line with the BCRA's purpose to "promote—within the framework of its powers and the policies set by the National Government, monetary and financial stability, employment and economic development with social equality", the BCRA considers it appropriate to work on the definition of a number of useful guidelines that may help different economic players in our country to shape their expectations. These guidelines are concerned with interest rate, prices, monetary aggregates, exchange rate, credit, economic activities, and employment.

- Interest rate. Given the inertial components of the ongoing inflationary process and the shallow local credit market, the attempt to reduce inflation by solely appealing to excessively high real interest rates has proved to be ineffective and eventually counterproductive. The real interest rate must preserve the economy's financial and foreign stability and must be in symphony with production financing and a longer-term yield curve, favoring domestic currency savings. The latter implies managing interest rates so that they may not be negative in real terms.

- Prices. The aim is to cause the inflation rate to gradually, though sustainably, go down following a prudential monetary policy consistent and coordinated with the rest of the economic policy and income policy promoted by the national government. In this context, inflation rate is expected to slow down well below 2019 due to concurrent monetary, exchange and fiscal policies, price agreements, and coordinated short and long-term strategies followed by different institutions.

- Monetary aggregates. They are at historically low levels in terms of GDP. Against the backdrop of confidence recovery and a gradual reduction in interest rates that may improve credit conditions and boost economic activities, the remonetization process is expected to be gradual. The monetary policy should promote a prudential expansion of monetary aggregates, avoiding imbalances that may directly or indirectly affect the inflationary process.

- Exchange rate. A managed floating exchange rate policy is a suitable instrument for avoiding marked fluctuations in the exchange rate parity that may adversely affect competitiveness, domestic prices, and income distribution. The exchange policy will also promote the precautionary acquisition of international reserves derived from the proceeds from exports.

- Credit. Internal credit intermediation is very low in relative terms. Strategically it should be expanded to meet the needs of households and production in the short, medium and long run.

- Economic activities and employment. The policies adopted so far will enable to define a new macroeconomic framework based on the recovery of the domestic market and the growth of exports by boosting investment and production. This will contribute to combine the expansion of demand and employment with a sustained productive transformation.