

1. Monetary Policy: Assessment and Outlook

One year after the onset of the COVID-19 pandemic and despite the promising scientific progress made in the fight against it, we still do not know when the world will definitely defeat the disease and start to live in the new “normality”.

In this context of global uncertainty, the Argentine economy has firmly continued to make progress in the regularization process during recent months. Increasingly more sectors have resumed their activities, on the basis of the health protocols implemented to prevent an acceleration in the speed of transmission. The evolution in health care and the adoption of unprecedented fiscal and monetary stimuli enabled an economic recovery process which started in May and continued all year long. As a result, in December 2020, GDP stood at only 3% in real terms below the pre-pandemic level. In turn, employment and wages were in line with the greater momentum of the economic activity and, together with a lower precautionary saving by households, helped sustain higher private spending levels. Once again, in the fourth quarter of 2020, investment grew at a faster pace than consumption, mainly due to the construction business activity and, to a lesser extent, to the acquisition of durable equipment for production.

In 2020, inflation went down 17.7 percentage points (p.p.) against 2019, standing at 36.1% year-on-year (y.o.y.) in December. During the last months of 2020, several factors converged and resulted in a temporary increase of the monthly inflation levels, including a sharp rise in the price of meat –because of the higher cost of forage related to commodity international prices– and the price adjustment of activities –which had been closed during the Mandatory and Preventive Social Isolation (ASPO)– when they started to operate once again. Even though, January inflation remained unchanged against December 2020, there was a combination of a moderate core inflation and an acceleration in regulated prices. For the next few months, the declining trend in core inflation is expected to continue due to the disappearance of the abovementioned temporary effects, giving rise to a reduction in headline inflation. In this respect, the Central Bank of Argentina (BCRA) will keep its managed exchange rate policy so that the exchange momentum may contribute to consolidate a gradual process of reduction in the inflation rate. In turn, given that the BCRA's main objectives are accumulating international reserves and keeping an external surplus, the monetary authority will seek to sustain a competitive real exchange rate in line with the economic fundamentals.

The gradual recovery of the economic activity in the second half of 2020 resulted in an increase in tax revenue and a reduction of government spending. This reduction was mainly due to the lesser influence of the extraordinary relief measures for households and companies adversely affected by the pandemic. Consequently, the fiscal deficit in 2020 was considerably lower than originally estimated in the National Budget Bill for 2021. In turn, the progress made by the National Government to rebuild the debt market in pesos, after the process aimed at restoring the public debt sustainability, helped the National Treasury finance a larger proportion of its needs through the market. In turn, this helped reduce the financial aid to the National Treasury by the end of 2020 and even cancel Temporary Advances, resulting in no transfers by the Central Bank so far in

2021. Likewise, in order to provide higher liquidity and depth to the sovereign debt market, the BCRA will continue intervening via open market operations.

As a result of a reduced expansionary bias in the fiscal and monetary policies applied in the second half of 2020, monetary aggregates started to moderate. In fact, as from July, the level of M2 in terms of GDP started to go down gradually, in line with the ongoing decline of the means of payment and the recovery of the economic activity. Thus, M2 ended the year at around 14% of GDP, standing only 0.9 p.p. above the average recorded between 2010 and 2019. On the other hand, the Monetary Base ended 2020 at a level equivalent to 7.4% of GDP, i.e. 1.0 p.p. below the average of the 2010-2019 period. In both cases, the end-of-the-year readings were in line with the estimates anticipated in the previous issue of the Monetary Policy Report (IPOM).

As the risks associated with COVID-19 start to weaken, the monetary policy will continue to be focused on absorbing the countercyclical efforts so as to preserve the monetary and financial balance and ensure the conditions required for a gradual reduction of the inflation rate.

The objective of the interest rate policy implemented by the BCRA in 2020 was twofold: to protect saving in pesos and to provide funding under favorable conditions aimed at offsetting the sharp decline in turnover during the pandemic. The minimum-interest rules adopted for time deposits resulted in a marked expansion of time deposits in pesos throughout the year. The average monthly growth of deposits stood at 5% during 2020 and continued in the first month of 2021. Consequently, the y.o.y expansion rate stood at 24.4% in real terms in January, slightly above the maximum figures recorded between 2004 and 2019. Specifically, in late 2020, the so-called UVA deposits and also dollar-pegged variable interest rate time deposits (DIVA dollar) exhibited a marked momentum, even though their share in total deposits is still relatively limited. Given the temporary nature of the inflation acceleration, the availability of instruments with variable rates based on the inflation rate and the exchange rate, and the uncertainty about the evolution of the pandemic in the next few months, the monetary authority decided to keep the interest rates of monetary policy instruments unchanged.

As regards the credit policy, one of the BCRA's structural objectives is to promote credit as a tool for productive and technological development. The emergency created by the pandemic required a series of extraordinary credit stimulus measures to contain the adverse impact on both households and companies. The policies implemented by the BCRA sought to give credit a countercyclical role which, in December 2020, stood at 8.5% of GDP (1.4 p.p. above the figure recorded in late 2019).

The gradual regularization of the economy allowed the BCRA to focus its loan assistance policy at subsidized interest rates on the hardest-hit sectors. However, there are still important challenges ahead related to the evolution of the pandemic that will require a credit policy that may quickly adjust to the needs of a changing and dynamic juncture. Thus, in October 2020, the BCRA launched the Credit Line for Productive Investment (LFIP) which concentrated, in one single instrument, the funding created by the BCRA to meet the needs of the pandemic and allowed to

adjust the interest rates at levels consistent with the monetary policy rates. As from its implementation, the LFIP has been the instrument used to channel loans for commercial purposes. By the end of February, this line accumulated disbursements for a total amount of \$295.94 billion, resulting in an increase of 200% in real terms against the figures of late November 2020.

Within a context of limited fiscal and monetary room due to the preexisting restrictions, the foreign exchange policy, as a strategy to respond to the pandemic, created some tensions in the foreign exchange market. The method used to manage these tensions served to underline the relevance of the monetary policy as an instrument for the stabilization of the financial situation and the external sector. The exchange measures adopted at the beginning of the fourth quarter of 2020 were supplemented by new exchange regulations in recent months. In the same respect, the objective is to keep a competitive exchange rate so as to prevent undesired effects on trade flows, domestic prices and income distribution. These measures allowed the BCRA to progressively reduce the selling position of foreign currency in the exchange market and to later become a net purchaser as from December 2020. Thus, despite the fall in International Reserves along the year, the BCRA managed to reverse such trend in December.

In this context, according to Article 42 of its Charter, the BCRA released its goals and plans for 2021 whereby it has committed to continue contributing to regularize the Argentine economy in coordination with the National Government's fiscal strategy, so as to lay the macroeconomic foundations for economic development with social equity. To this effect, during 2021, the Central Bank's monetary, exchange, credit and financial policies will seek to favor the economic regularization, build a process tending to restore confidence in the domestic currency, sustain a gradual process of inflation reduction, foster external balance, deepen the recovery of private loans, preserve financial stability, promote the development of the capital market and encourage greater financial inclusion¹.

¹ For further detail, see: <http://www.bcra.gob.ar/Pdfs/Institucional/OyP%202021.pdf>.