

Monetary Policy: Assessment and Outlook

The international context has become more uncertain in recent weeks. Even though the global economy closed 2021 with a 5.7% yearly expansion of GDP, a new wave of the pandemic in the first months of 2022 and, more recently, the armed conflict between Russia and Ukraine have impacted on the momentum of the economic activity. This last event has heightened the uncertainty about the future outlook of commodity prices that are exported and imported by Argentina. So far, the increase in the price of energy and of the remaining commodities led to inflation acceleration in advanced economies, forcing their central banks to give their monetary policies a more contractionary bias. A sharper monetary contraction would impact on developing countries via tighter financial conditions, capital outflows and, eventually, lower growth.

In Argentina, within a more favorable health-related context due to a higher number of people with full vaccination schemes, the economic activity continued to improve in the fourth quarter of 2021 and operated at levels higher than in the pre-pandemic period. Thus, the year ended with a growth rate of 10.3%, standing significantly above the originally expected figures. The leading indicators of the economic activity have shown less dissimilarity across sectors. For 2022, the economic activity recovery process is expected to continue, driven by a sustained momentum of the sectors that have not yet managed to operate at pre-pandemic levels, especially services.

Against this more dynamic macroeconomic backdrop, inflation accelerated once again in the first two months of the year and reached a 4.3% monthly average, standing above the 3.3% monthly average observed during the fourth quarter of 2021. Higher prices as from September 2021 occurred in a context of recomposition of marketing margins in some sectors, reopening of collective bargaining agreements and higher inflation expectations as a result of the heightened foreign exchange pressures typically associated with electoral processes, where the private sector usually reinforces its financial dollarization patterns, added to the financial uncertainty caused by a final definition for the country's negotiation with the IMF in order to reach a new debt agreement. This high inflation inertia was accompanied, as from January, by domestic unfavorable climate conditions and a significant rise in international commodity prices related to agriculture and energy, and also in global manufactures, which have accelerated recently due to the conflict between Russia and Ukraine, posing a challenging scenario for the near future and especially for the next two months.

Once the pre-pandemic economic activity levels were reached and without neglecting the ongoing growth process, the BCRA sought to resume the monetary policy guidelines articulated in early 2020, which combine consolidation of exports and the domestic market growth with monetary and macrofinancial stability. In this context, the BCRA defined its Objectives and Plans¹ for 2022 and published the report in December 2021.

Keeping a reserve accumulation process that may drive away the risk of a balance of payments crisis and of sudden leaps in the exchange rate, thus anchoring exchange expectations, is a precondition to reduce the levels of inflation inertia. Thus, in order to strengthen the international reserves position, the BCRA changed its depreciation pace in order to gradually take it to levels that are more consistent with the domestic inflation rate. Consequently, so far in 2022, the Multilateral Real Exchange Index (ITCRM) has

¹ http://www.bcra.gob.ar/PoliticaMonetaria/Politica_Monetaria.asp.

stabilized and it is now standing at the levels required to preserve external competitiveness and around the average of the last 24 years.

Likewise, as from the first week of January, the BCRA has reshaped its monetary policy instruments in order to accompany the economic recovery process and reinforce monetary, exchange and financial stability. To this effect, it has raised the reference interest rate on two occasions, from a nominal annual percentage rate of 38.0% (effective annual percentage rate of 45.4%) to a nominal APR of 42.5% (effective APR of 51.9%). The BCRA has also readjusted the limit on holdings of 28-day LELIQs (thus focusing the sign given by the monetary policy interest rate on such instrument), created new instruments to lengthen the average sterilization term and raised the minimum interest rates on time deposits. The monetary policy interest rate rise seeks to achieve positive returns in real terms on domestic currency investments, so as to foster the demand for pesos. This is why, with a view to the future, the news about inflation issues will be seen in the calibration of the interest rates performed by the monetary authority.

In turn, the BCRA will continue gauging economic liquidity by sterilizing any eventual surpluses, in order to contribute to preserve monetary equilibrium. In this respect, the primary expansion related to the public sector stood at significantly lower levels in 2021 than in 2020, mirroring values relative to GDP similar to those of previous years; so far this year, it has helped contract liquidity in the market. The purchase of foreign currency from the private sector has also contributed positively to the Monetary Base expansion during 2021 and in early 2022. These factors were partially sterilized through monetary regulation instruments (reverse repo transactions and LELIQs). Even so, the Monetary Base ended the year with a 40.0% expansion which, in real terms, entails a contraction, while the stock of remunerated liabilities stood at around 9.7% of GDP. Given the estimated growth of the monetary base demand, every percentage point (p.p.) of increase in the monetary policy interest rate is expected to result in an increase in remunerated liabilities of 0.07 p.p. in terms of GDP. Even taking into account this effect, remunerated liabilities will go down relative to GDP in 2022, within a context of reduced sterilization needs.

The continuity of the activity regularization process in the productive sectors allowed the BCRA to go on with its lending policy focused on the sectors that are still lagging behind and on a boost to productive development. During 2022, the Central Bank will continue to encourage credit supply to the private sector. Once again, the Credit Line for Productive Investment (LFIP) will be the main vehicle to provide credit for production purposes to micro, small and medium-sized enterprises (MSMEs) under favorable financial conditions.

In this monetary policy framework, the National Government has recently reached an agreement with the International Monetary Fund (IMF) to implement an Extended Fund Facility (EFF) that will help cover the maturities of the Stand-By Agreement (SBA) signed in 2018, obtain budget support to partially fund the National Treasury's needs and reinforce the Central Bank's reserves.

Within the framework of this agreement, repayments will start by mid-2026 (fourth year after signing the agreement) and will extend until the tenth year after the last disbursement, i.e. in 2034. The macroeconomic policy scheme agreed with the IMF provides for a gradual decrease of the Federal Government's primary deficit, without reducing government spending in real terms so as not to impact adversely on the GDP recovery process now in progress. Likewise, the monetary aid to the Treasury in terms of GDP will go down from 1% in 2022 to zero in 2024. Regarding the remaining policies implemented by the BCRA, the guidelines introduced to the agreement are consistent with the Objectives and Plans adopted for the current year. The main objective will be to keep the reference interest rate at the level required to protect the value of the

Argentines' savings in real terms, and to contribute to the depth of the public debt domestic market. Regarding the external front, the agreement seeks to keep the domestic currency depreciation pace at the level required to reinforce the accumulation of International Reserves.

It is estimated that this scheme of macroeconomic policies will contribute to sustain the ongoing economic recovery within a context of lower inflation levels, so as to streamline the improvements already achieved in terms of social conditions and employment. To this effect, the National Government and the Central Bank will seek to: (1) improve public finance and debt sustainability, without endangering growth as well as the narrowing of social gaps and infrastructure; (2) strengthen external sustainability via the accumulation of international reserves by means of policies aimed at boosting trade surplus, promoting exports and long-term capital inflows and enabling an eventual access of Argentina to international financial markets in the medium term; (3) reduce the inflation rate gradually and persistently based on the coordination of monetary, fiscal, income and price policies; and (4) create the conditions to ensure the sustainability of the growth process while protecting the environment, by mobilizing domestic saving, strengthening investment in infrastructure and innovation, and promoting strategic tradable sectors.