Monetary Policy: Assessment and Outlook

The international context is now more complex after the recent bankruptcy of the Silicon Valley Bank in the United States and the redemption of the Credit Suisse in Europe. In both cases, the monetary authorities reacted quickly by pumping liquidity to prevent a spillover that might result in systemic problems. Even though the global growth forecasts available by the time of closing this issue of the Monetary Policy Report (IPOM) had not considered yet the potential negative impact of these events, the perspectives of a reduced economic activity continued to prevail. Likewise, there is more uncertainty now about whether the US Federal Reserve (FED) will continue to prioritize its anti-inflationary objective by means of additional policy interest rate rises and reduction of its balance sheet size, or if it will instead revise its strategy in view of the risks for financial stability. Even though the impact on Argentina would be limited through the financial channel, it would nevertheless be felt in case it ends up affecting adversely the growth rate of our main trading partners, the valuation of the financial assets and emerging countries' currencies, and commodity prices.

In Argentina, the economic activity interrupted its expansionary trend by the end of 2022. The 1.5% drop seasonally-adjusted (s.a.) observed during the fourth quarter was widespread and affected all the components of internal demand, but it was partially offset by an increase in the exports of goods and services. The negative statistical carryover left by the last quarter of 2022 for the current year (-0.3 percentage points —p.p.—) and the mixed signals provided by the leading data of the first months of 2023 were accompanied, in February and March, by highly adverse climate conditions —drought and early frosts— in the main producing areas of the country, which resulted in a marked correction of the domestic production estimates of soybean and corn. In a context of heightened financial uncertainties at global and domestic levels, these trends will put a cap on the economic activity in the next few months.

In terms of prices, after a period of deceleration when the monthly inflation rate went from 7.4% in July down to 5.0% on average in the last two months of 2022, inflation went up again in January and February 2023 and averaged a monthly 6.3% rate (+0.8 p.p. against the last quarter of 2022). The Seasonal and Regulated Prices categories of the Consumer Price Index (CPI) and the highly volatile group of Meat and meat products —with a high share in the Core Inflation category— posted the quickest acceleration in early 2023. Core Inflation, excluding Meat and meat products —which could be considered a more structural measure of the underlying inflation— stood at 5.8%, on average, in the first two months of 2023, and accelerated more moderately against the last quarter of 2022 (5.6%). The year-on-year (y.o.y.) inflation rate continued to go up to 102.5% in February against an annual inflation of 94.8% in 2022.

In this context, by mid-January, the BCRA raised the interest rate applied to shorter-term instruments and reverse repo transactions with financial institutions and Mutual Funds, seeking to reinforce financial and exchange stability. Likewise, in March, in view of the higher inflation figures, the monetary authority decided to raise by 300 basis points (bp) the interest rate on 28-day Liquidity Bills (LELIQ), which was then set at a nominal annual percentage rate (APR) of 78% (effective APR of 113.3%). In line with this increase of the monetary policy interest rate, the minimum rates paid on the private sector time deposits were also adjusted, for both natural persons up to ARS10 million and for the remaining depositors.

Thus, interest rates have continued to keep a positive sign in real terms, which ensures the protection of saving in pesos and contributes to keep exchange and inflation expectations properly anchored. The BCRA will continue monitoring the evolution of headline inflation as well as the dynamics of the exchange market and the monetary aggregates in order to gauge its policy on interest rates and liquidity management.

By the end of March 2023, the BCRA's international reserves were standing at USD39.06 billion, posting a drop of USD5.54 billion against the figure recorded last December. This result is mainly due to payment of the National Treasury securities for around USD1.6 billion, and to net sales by the BCRA in the exchange market for around USD3 billion. It is worth mentioning that the lower net income from the "Oilseeds and grain" sector is behind the drop in reserves observed during the first quarter of the year (down 74% against the net income of the first quarter of 2022) because of the impact of the severe drought and the early frosts on the production and exports of agricultural products and their byproducts (wheat, corn and soybean pellets). There were also other factors, such as the partial cancellation of this sector's commercial debt by the end of last year within the framework of the "Export Increase Program" and the seasonality change in the payment of energy imports to take advantage of the international market's current prices as well as to ensure the supply of gas in winter.

The agreement reached by the IMF and the Argentine authorities at technical level on the fourth review of the Extended Fund Facility Arrangement, and its recent approval by the Executive Board of this multilateral financial institution, consolidates the monetary policy framework being implemented since the end of the pandemic. On this occasion, it has been admitted that Argentina faces a more challenging context to develop its economic policies. Consequently, no changes have been introduced to the objectives, which require a stronger consolidation effort, except for the reserve target for 2023, which has been eased due to the recognized impact of the drought on Argentina's commodity exports.

In the next few months, the BCRA will continue gauging its policies to reduce inflation. In this respect, it will continue adjusting the monetary policy interest rate if the financial and exchange conditions, and the price dynamics, so require. It will also seek to preserve financial stability using its intervention capacity through open market operations in order to promote better liquidity, depth and transparency in the sovereign debt markets. Regarding the foreign exchange market, the Central Bank of Argentina will continue to adjust the crawling peg exchange scheme in order to preserve the external competitiveness level, by gradually readjusting the crawl rate within the current managed float system to a level consistent with the inflation pace. This framework will be supplemented by other measures intended to foster the increase of exports in order to strengthen international reserves. Likewise, it will continue prudently managing exchange regulations in order to adjust them to the context-related needs. To the extent that the macroeconomic conditions so allow, the BCRA will seek to gradually ease regulations in order to keep a set of medium and long term macroprudential regulations consistent with more dynamic capital flows channeled to the real economy. Lastly, the monetary authority will continue prudently managing monetary aggregates by sterilizing any eventual excess liquidity with monetary regulation instruments so as to preserve monetary equilibrium.