

# 1. Monetary Policy: Assessment and Outlook

The international context has become more complex in the last three months. The deepening of the war conflict in Ukraine has pushed food and energy international prices up and has undermined the momentum of the global economic activity. The higher inflation pressures resulted in a monetary contraction cycle in advanced economies, a situation that turned out to be more heightened than expected at the beginning of the year. In turn, rises in global interest rates exerted pressures on the financial assets listed in the main stock markets all over the world, led to a global appreciation of the US dollar and compounded the risk of capital outflows from emerging countries. For developing countries in general and Latin American countries in particular, the new context has opened different scenarios in terms of growth and inflation depending on whether the upward pressures on commodity prices continue to stand, with the resulting appreciation of real exchange rates, or the dollar appreciation leads to lower commodity prices and more depreciated exchange rates.

The Argentine economy has consolidated the recovery process started in 2021 and continued to operate at levels above pre-pandemic values, with increases in the investment rate. This improvement in the economic activity was accompanied by a recovery in registered employment, which has reached its maximum figure in historical terms. After a growth path during the first quarter, GDP is likely to contract slightly during the second quarter due to the impact of the drought that has adversely affected the main producing regions of soybean and corn during summer (in the Southern Hemisphere) and is then expected to resume its growth path in the last six months of the year and close 2022 with an expansion of around 4%. In this context of ongoing recovery of the economic activity, the Central Bank of Argentine Republic (BCRA) has focused its credit policy on the sectors that are still lagging behind and on financing productive development and structural change. The Credit Line for Productive Investment (LFIP) continued to be the main tool used to provide loans for productive purposes to micro, small and medium-sized enterprises (MSMEs) under favorable conditions. The average stock of lending granted under the LFIP between October 1, 2021 and March 31, 2022 amounted to ARS670 billion.

In March 2022, inflation accelerated remarkably and stood at a historically-high monthly rate of 6.7%. Such increase was mainly evident in the Core Inflation category and, within such category, mainly impacted on the price of food products, driven by the rises observed in international commodity prices, as a result of the war conflict in Ukraine. This external shock adversely affected Argentina, which was experiencing a recovery of its economic activity added to a previous high inflation inertia. After the peak reached in March in Headline Inflation, the data corresponding to May confirmed the inflation slowdown that had started in April and recorded a significant decrease in the Core Inflation category. Nevertheless, inflation records are still standing at high levels, in part due to the existence of formal and informal indexation mechanisms that contribute to worsening the size and persistence of the shock.

In the face of this context, the monetary authority continued consolidating the regularization process of the monetary policy interest rate and the structure of the other interest rates of the Argentine economy, seeking to pave the way for an interest rate process that may allow to preserve the value of the investments made in instruments denominated in domestic currency and prevent pressures on the foreign exchange market, without impairing the economic recovery in progress. By the date of publication of this Report, the 28-day LELIQs interest rate was standing at a nominal annual percentage rate of 52% (effective annual percentage rate of 66.5%), entailing an aggregate rise of 14 percentage points (p.p.) since early 2022. Likewise, so far this year, the floor for the interest rates on time deposits made by natural persons

has accumulated a rise of 19 p.p. for the segment between ARS1 and ARS10 million, and of 16 p.p. for the segment below ARS1 million, currently standing for both types of deposits at a nominal annual percentage rate of 53% (effective annual percentage rate of 68%). For the remaining time deposits from the private sector, the minimum guaranteed interest rate accumulated a rise of 16 p.p. to a nominal annual percentage rate of 50% (effective annual percentage rate of 63.2%).

For the purpose of containing the impact of price acceleration, the Federal Government decided to mitigate the loss in the purchasing power of the income received by people without formal income and/or in a vulnerable socioeconomic situation. Likewise, the increase in the price of energy impacted adversely on public finance. This greater need of financing was covered by turning to multiple sources, including monetary financing. Thus, so far in 2022, the monetary aid to the Treasury in GDP terms stood at a level similar to that of the pre-pandemic years. On the other hand, in June, due to a heightened volatility in the global and domestic financial markets, the BCRA intervened in the sovereign bonds' secondary market in order to rebuild the Treasury's curve in pesos, within a context of an excessive and unjustified price volatility that might jeopardize financial stability. Added to these operations, there was an expansionary effect on the monetary base that was offset with operations intended to sterilize excess liquidity. All in all, if seasonally-adjusted and at constant prices, the monetary base is standing at historically low levels and it reached a historical floor in terms of GDP in April. The BCRA will continue to prudently manage the monetary aggregates and will sterilize any potential excess of liquidity in order to prevent imbalances that may directly or indirectly go against the disinflation process.

Looking into the future, the Federal Government and the BCRA will continue adopting measures to reduce inflation. In this respect, the current scheme of policies subject to the framework of the agreement reached with the IMF will allow to consolidate a context of macroeconomic certainty that will help limit any expectation of increase in the exchange rate and the inflation rate. Recently, the IMF and the Argentine authorities have come to an agreement, at technical level, on the first review of the Extended Fund Facility Arrangement. The main purpose of the review was to assess the performance as from the approval of the arrangement, by addressing the impact of the war in Ukraine on the Argentine economy and identifying policies intended to mitigate its effects. In order to strengthen macroeconomic stability, an agreement was reached not to introduce changes to the annual objectives related to primary fiscal deficit, monetary financing and net international reserves established in March, but to change their quarterly path. After compliance with the quantitative goals of the program for the first quarter of 2022, the agreement on the first review was approved by the IMF Executive Board.

The BCRA will continue gauging the monetary policy according to the evolution observed and to the outlook of Headline Inflation, and will reinforce measures to align its monetary policy with the BCRA's Objectives and Plans for 2022, where the monetary authority has set the goal of taking the monetary policy interest rate towards a path of positive real returns on the investments made in domestic currency.