Monetary Policy: Assessment and Outlook

The international context continues to be favorable for Argentina. The global economy has kept its path of recovery during the third quarter, even though it is growing at a slower pace than in recent months. The latest forecasts have kept global economic growth projections virtually unchanged for the current year and the next one (5.8% and 4.8%, respectively). On the other hand, the prices of commodities exported by Argentina have stood at high levels in historical terms, even though with a slight decline on the margin. Looking forward, external risks are mainly related to the implications of a rise in the international price of energy which, within the context of rising inflation expectations in advanced countries, might speed up the reduction of the monetary stimulus policies adopted during the crisis and decelerate the growth pace worldwide. In turn, any eventual new outbreaks of COVID-19 Delta variant or the propagation of new variants that might force to reintroduce sanitary measures intended to restrict circulation might have a similar adverse impact.

In Argentina, there has been a systematic drop in the rate of COVID-19 infections as from June, which stood at minimum levels in October. This improvement in the epidemiological situation resulted from the remarkable pace of the vaccination campaign. The lesser impact of the second wave and the quick ensuing recovery helped give continuity to the domestic process of economic reopening and invigoration, even though sectoral performances continue to be mixed. It is estimated that the activity will continue to be on the rise for the rest of the year, driven by flexibilizations in terms of both activities and capacity (occupancy), supported by a greater vaccination coverage of the population with complete vaccination schemes and by the stimulus policies implemented by the National Government and the BCRA. All in all, GDP would grow around 9% in 2021, also giving rise to an improvement in employment rates.

In a more dynamic macroeconomic context, retail inflation stood at 3.5% in September and October and exceeded the monthly average observed during the third quarter (3%). Core inflation, which is essentially less volatile, has also stood at a high level since July, close to 3.2%. Some temporary factors, which were anticipated in previous issues of the Monetary Policy Report (IPOM) have impacted, even though with a greater intensity than expected, on an inflation inertia that has stood at high levels in recent months. These factors include the influence of international prices, which have been lately more related to the price of energy and the cost of global manufactures, the recovery observed in the marketing margins in some sectors and the rearrangement of relative prices in private services after the reopening of activities due to the improved epidemiological situation and, to a lesser extent, the wage adjustments resulting from the collective bargaining agreements. Added to this, the electoral process gave rise to heightened volatility in foreign exchange expectations.

The BCRA has faced these weeks of increasing financial volatility by gauging its intervention in the spot and forward exchange markets and by adapting its exchange regulation in order to preserve foreign exchange stability. It is worth mentioning that the Central Bank has made purchases in the exchange market for the sum of US$6.42 billion from January to October, reaching the highest value for the first ten months of the year since 2012, while international reserves increased US$3.43 billion over the same period, mainly considering the payments of principal and interest on the National Government's debt in foreign currency and the BCRA's open market operations. As of the date of publication of this Report, and also including the Special Drawing Rights (SDRs) allocated to the country by the IMF to mitigate the impact of the pandemic, international reserves stood at around US$42.6 billion and, despite the lesser momentum of the nominal exchange rate in recent months, the Multilateral Real Exchange Rate Index (ITCRM) stood at competitive levels, at around the average of the last 24 years.

The BCRA gauges economic liquidity by sterilizing any eventual surplus in order to help preserve the monetary balance. In this respect, so far this year, the primary expansion related to the public sector stood at remarkably lower levels than in the previous year of the pandemic, posting values similar to those of previous years in terms of GDP. Thus, in the third quarter of 2021, the monetary base grew 6.8% and, in October, it expanded at a pace similar to that of the previous three months. In year-on-year terms and at constant prices, the monetary base has contracted, reaching a -17.1% change in October and standing at records similar to those of mid-2003 in terms of GDP.

In order to support the economic recovery, the BCRA has intensified its credit policy, which is now focused on the sectors that are still lagging behind and on a major drive to productive development. The Credit Line for Productive Investment (LFIP) continued to be the main tool to channel loans for productive purposes to micro, small and medium-sized enterprises (MSMEs) under favorable financial conditions. Since its implementation and based on data as of October 31, there have been disbursements under the LFIP for a total amount of $1.19 trillion. The BCRA has recently decided to extend the LFIP Credit Line until late March 2022 and has extended the line to some specific sectors. Boosted by the LFIP, the stock of loans to companies of smaller relative size has exhibited a sustained increase in real terms since early August, reaching an average monthly rise of 2% in the third quarter and accelerating up to 4.9% in real terms, seasonally-adjusted (s.a.), in October. Regarding the loans related to consumption, financing with credit cards has recovered since late September, mainly due to the re-launch of the "Zero Interest Rate Credit Line" intended for workers under the Simplified Tax Regime (*monotributo*) for Small Taxpayers.

In the next few months, inflation is expected to resume a path of gradual deceleration as soon as the temporary factors that impacted on headline inflation start to recede. In this respect, the BCRA will focus its efforts on favoring a macroeconomic context marked by lower inflation levels than those being observed at present, without impairing the economic recovery in progress. In turn, the recent decision by the National Government to establish temporary maximum prices for sales to end consumers, which is focused on rolling back the prices of a group of products to the values of early October and keeping them unchanged until January 2022, will also contribute to lessen inflation in the last months of the year. Looking into 2022, the possibility of an agreement with the IMF will help improve the expectations of those sectors anchoring their view about the sustainability of the external sector on the result of such negotiation, and contribute to contain foreign exchange pressures and inflation expectations. In this respect, the sustained growth of the economic activity and the moderation of the inflation rate will give rise to a higher demand for real money balances that would stand at around the average value recorded during the previous decade (2010-2019). In this new stage, a lesser need of financing the National Treasury and a renewed role of the debt market in pesos may help reduce the monetary sterilization effort. As a result, the monetary base demand would be satisfied by the interest associated with the BCRA's remunerated liabilities and by a potential reduction of their stock.