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What to Expect from Changes in Monetary Policy?

The government announced a new phase in the management of monetary policy. Starting this week, all net daily purchases of foreign currency by the Central Bank of Argentina (BCRA) in the official exchange market (MLC) will be offset by sales of foreign currency in the blue chip swap (CCL) market. It is worth noting that, to remove pesos from the economy, the BCRA must sell fewer dollars in the CCL than those bought in the MLC, given the exchange rate gap. In theory, the objective is to sterilize the pesos that come from the BCRA's dollar purchases from the private sector. Although the presidential obsession with remunerated liabilities and monetary issuance is well-known, the measure seems to have another goal: to reduce or stop the recent surge in the exchange rate gap. Let's highlight some key points.

The first point to highlight is the timing of the announcement. If the measure truly had a monetary objective, it would have made sense in the first five months of the year when the BCRA was purchasing a significant amount of foreign currency in the MLC. However, the BCRA has not been a net buyer in the MLC for almost a month and a half. We believe the measure would have been more understandable if the intention had been to remove the current "dólar blend" (80/20) for exports. If that were the case, the BCRA could buy more dollars in the MLC and keep the exchange rate gap aligned under the threat of intervention in the CCL.

The approach of intervention is not so clear. According to announcements by some officials on Twitter, the BCRA could use the dollars previously purchased to sterilize pesos. If the BCRA determines that the peso overhang is $2.5 trillion, the BCRA's selling capacity would be equivalent to USD 1.9 billion, a considerable amount. At the end of the day, the overhang of pesos remains a discretionary definition by the Central Bank.

High-frequency inflation data for the first half of July seems to be a concern for the government. The primary goal of the government is to lower inflation as quickly as possible, and the results have been quite encouraging. June's inflation was 4.6%, and core inflation dropped to 3.7%. Considering that tariff increases were suspended for July, the low statistical inertia from June allowed for optimism regarding July's figures. However, recent high-frequency measurements show an uptick in core inflation. This is due to a mix of two factors: firstly, we experienced extreme cold that pushed up the prices of seasonal items like fruits and vegetables, and secondly, the widening exchange rate gap likely accelerated prices to some extent. The economic team seems to have taken note of this last point.

Additionally, this measure has a significant side effect. The government appears to be focusing entirely on reducing the exchange rate gap and containing inflation, using a mix of valuable fiscal balance and an absurd overvalued exchange rate, abandoning the challenging goal of opening the secondary debt market in the short term. Accumulating reserves, no longer seems to be a goal of the BCRA, which was evidenced by the country risk premium. Bonds showed a decline at the opening on Monday. For now, the government seems to be moving away from seeking a voluntary debt rollover.

To mitigate this effect, the Treasury announced on the same day the purchase and wire of dollars to the Bank of New York to cover the interest payments of Global and Bonares bonds due in January 2025. This dollar purchase would be made with pesos accumulated from the fiscal surplus. This is an extremely positive signal for the markets, as it demonstrates a strong intention to meet commitments. However, there is a very relevant issue here: if the Treasury buys USD 1.528 billion with pesos at the official exchange rate, the question arises: who sells at that price of $920? At the end of the day, the BCRA does not have net reserves (they are negative) to sell dollars to the Treasury. To obtain dollars, the BCRA must resort to the reserves of deposits (international reserves that are gross but not net) or get new dollar funding.

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In the initial trading sessions, the measure achieved a significant reduction in the exchange rate gap at the cost of a tolerable increase in country risk premium. With a wide gap, this economic program—or indeed any program—would not work. The big question now is the sustainability and credibility of potential BCRA sales in the CCL. At this point, we have many doubts. The BCRA has no reserves and is not buying foreign currency in the MLC. Similarly, the goal of zero issuance is also arguable. Now the liabilities of the Consolidated Public Sector have moved from one pocket to another within the same bag, with the caveat that the new interest burden will have to be masked with some creative accounting, such as the famous capitalizable bonds or zero-coupon bonds, which prevent the financial deficit from increasing. We do not see problems with peso debt as long as fiscal discipline is maintained. However, another question arises for the future: What will happen with peso debt when the Treasury cannot roll over all the maturities? Let's not get ahead of ourselves; we already have enough with the present challenges.

As you may notice, we do not view the government's latest measures favorably. Neither the migration of debt from the BCRA to the Treasury nor the sale of dollars by the monetary authority seem like appropriate measures to us. We also do not believe that the (welcomed) undoing of the Central Bank's puts addresses the underlying issue. These measures do not resolve the core problem of this scheme: the extreme rigidity of the exchange rate system combined with an unreasonable overvalued exchange rate. The government wants more reserves to lift the currency controls ("cepo"), but with the cepo in place, it will not be able to accumulate reserves. The official thesis that the cepo can be lifted when the CCL converges to the official dollar— in other words, that the gap closes downward—contains a huge level of optimism.

Nevertheless, not all news is bad. This week, the fiscal results for June were released, showing six consecutive months of surplus, the first time in over 15 years. The year-to-date accumulation shows a primary surplus of 1.1% of GDP, a truly surprising figure. The government has admirably tackled Argentina's main obstacle to achieving stability—the chronic deficit financed by monetary issuance was eliminated in record time. However, as we always mention, fiscal correction is a necessary but not sufficient condition for stability. From the outset, we have seen the exchange rate scheme as inconsistent, and in recent weeks, the market seems to be seeing the same thing.

To conclude, let's focus on our business. Despite all the criticisms of the exchange rate and monetary framework, we find sovereign dollar bonds attractive. The significant progress in fiscal matters and the strong and consistent signals regarding payment commitments seem to us sufficient reasons to hold sovereign dollar bonds in the portfolio at these prices. The longer the exchange rate is overvalued or the cepo remain in place, the higher the probability of seeing an overall liability management. However, at these prices for Globales and Bonares bonds, we believe there is still potential for upside even in the scenario of a friendly debt swap.

Kind regards,

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