# Martín Redrado: Presentation of the 2009 Monetary Program

Speech by Mr Martín Redrado, President of the Central Bank of Argentina, before the Committee on Treasury and Budget of the National Senate, Buenos Aires, 30 December 2008.

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## 1. Introduction

One year ago, when I last addressed the Honorable National Senate to present the 2008 monetary program, I already emphasized with concern the hostile international financial scenario we had to face. On that occasion, I highlighted the uncertainty imposed by this scenario on monetary policy. In particular, I underlined the advantages of our risk management approach based on three pillars: the money market equilibrium, a managed float, and countercyclical policies that includes a proper regulation and financial surveillance.

I also mentioned that, from the Central Bank, we successfully weathered the first turmoil since the end of the 2001 crisis. Twelve months later, we have lived through three complex situations, which proves us right in the actions we have taken. The first one was the beginning of the sub-prime mortgage crisis in the United States (July-October 2007). The second episode was the abrupt imbalance in the demand for money after the rural sector conflict (April-June 2008); and the third relates to the worsening international crisis (mid-September 2008 onwards).

The performance of monetary-financial variables and the limited impact of these episodes on the real economy prove the soundness of our policies. Throughout recent years we have patiently and persistently built the right instruments to mitigate various shocks. Under a risk management approach where a central scenario is defined for the main variables, our strategy furnishes us with the right tools to face any deviation. We have mechanisms in place to provide or absorb funds as needed while preserving money market equilibrium. We have a sound, well-regulated financial system that is in a position to "cushion" any turmoil. All of this in a framework of abundant liquidity in foreign currency and a managed float with mildly fluctuating financial variables to reflect the natural convergence between the yields of Argentine peso- and US dollar-denominated instruments. This regime – which provides predictability and flexibility at the same time – is undoubtedly the best suited for the current economic stage. Moreover, this regime takes into account both our long history of macroeconomic volatility (and *de facto* dollarization of the peoples financial behavior) and consistency with the macroeconomic program as a whole.

In this presentation, I will firstly highlight Central Bank actions to manage the different volatility episodes during 2008, including the evolution of monetary aggregates vis-à-vis the program for this period. Secondly, I will explain the rationale behind the different pillars underpinning our strategy, especially the managed float. Finally, in the light of my forecasts regarding the national and international economic scenario, I will state the monetary targets and guidelines set forth by the Central Bank Board of Directors for 2009.

## 2. 2008: another challenge for the monetary regime

In my view, any recipe to overcome a crisis or financial turmoil should have three essential things.

First: to have a definite reaction. Action should be forceful in order to curb expectations and rebuild confidence – it should reflect that authorities are persuaded that the path to follow is the correct one.

Second: simplicity. The instruments used should be transparent and clear in order to be more effective. Action can be technically flawless but, if agents have trouble interpreting it, it can cause uncertainty and become ineffective.

Third: delivery capacity. Effectiveness to overcome complexities related to the implementation of any action is an important condition allowing, at the same time, to gain credibility.

This is, in short, the Central Banks view in action. In order to face these crisis episodes, we have sequentially adopted a series of measures. In the first place, we reacted in a definite way, acting firmly in an attempt to normalize the money demand and stabilize the foreign exchange market. Then, with simple instruments, we ensured liquidity provision to guarantee systemic stability. Finally, in order to make it more "down-to-earth," we implemented an array of measures including reforms on the markets for Central Bank securities, the development of additional mechanisms for liquidity provision, changes to enhance futures market depth and transparency, and instruments to facilitate US dollar supply.

During the three critical episodes, we noticed a marked mismatch in the demand for money that activated the warning signals on our instrument panel. Private sector time deposits showed a temporary decline, just as during previous financial crises. The same happened with the size of the capital account reversal. Having adequately assessed the costs and benefits of each instrument beforehand, we focused all our efforts on restoring money market equilibrium. A quick and "surgical" reaction allowed us, in the first place, to strengthen the demand for pesos and facilitate foreign currency supply. In this respect, and in order to put the complexity of this task into perspective, it is worth remembering that the demand for money is decided by the public and that our capacity to influence that decision is mostly indirect and limited.

In fact, through transactions in the spot and futures markets, the potential pass-through of depreciation trends to domestic prices has been avoided. At the same time, these actions had a positive impact on the recovery of the demand for domestic assets and assurance of systemic stability. Once the foreign exchange market was relatively calm, we undertook to improve domestic currency liquidity so as to ensure financial stability and a smooth chain of payments. The sterilization policy that we developed in recent years facilitated our job, furnishing us with the necessary tools to efficiently provide funds this time. Central Bank actions included the repurchase of LEBACs and NOBACs in the secondary market and a partial renewal of those maturing. Thus, the liquidity reserve feature of these securities was confirmed: issued in the face of excessive liquidity and redeemed when market conditions so require. In fact, the Central Bank securities stock went from almost ARS 51.5 billion in late 2007 to approximately ARS 36.7 billion at present. This change in the composition of liabilities is perhaps less visible than the trend of reserves, but is a part of our scheme as well.

In turn, we also intervened by purchasing Government securities in pesos or US dollars in the secondary market, aiming to provide liquidity beyond the financial system. This is something that most central banks in the world do as part of their open market operations. More precisely, we took eighteen steps to adapt our scheme to the new scenario:

- The repo market was reformed, offering liquidity at a fixed and floating interest rate;
- The maturing Central Bank bills and notes (LEBACs and NOBACs) were partially renewed, and there was repurchase in the secondary market;
- We resorted to open market operations by purchasing Government securities that can be liquidated in Argentine pesos so as to inject liquidity and preserve money market equilibrium;
- Minimum cash requirements were unified for June and July into a single bi-monthly term, thus improving the system liquidity management;

- A mechanism for US dollar-denominated repos was established, aimed to curb peso depreciation expectations;
- The Central Bank started trading in the non-deliverable forward (NDF) market, with one-year-maximum operations and counterparties whose credit rating was AA or above;
- A new repo window was opened that allows for certain instruments to be used as collateral (Bogar and guaranteed loans) that cannot be used in traditional repos;
- The limits to operate in the futures market were extended, both for the Central Bank and those agents associated with some of its counterparties. It is worth mentioning that our institution only trades with contracts that are cleared in domestic currency;
- The reference exchange rate for futures and forward transactions between the Central Bank and its counterparties was allowed to be set by the Emerging Market Traders Association;
- New maturity options were offered for reverse repos, readjusting the terms and conditions;
- The liquidity provision scheme was extended, allowing banks that hold (6-month-maximum) LEBACs and NOBACs to have instant liquidity;
- Repo yields were adjusted twice;
- A mechanism has been established for auctioning options on LEBACs and NOBACs, allowing institutions to on-sell these securities to the Central Bank before maturity at a pre-established discount (a spread over BADLAR rate);
- Minimum cash requirements were lowered for foreign currency deposits in order to increase the availability of funds to finance foreign trade;
- Financial institutions' minimum cash requirement was unified for October and November into a single bi-monthly term;
- A new window was established to rate collaterals for the financial assistance regime;
- In order to meet reserve requirements, institutions were temporarily allowed to include their total cash holdings in the calculation, even items in transit (in the past, they were only allowed to include two thirds);
- The fixed-rate repo line was raised from ARS 3 to 10 billion.

These measures stressed the "buffer" role played by the Central Bank to limit the effects of turmoil on the real economy. Also, adequate risk-management mechanisms and the proper use of policy tools allowed us to discourage speculative attacks. Thus, even though we are going through one of the worst crises in the history of the global financial system, the set of policies implemented resulted in a satisfactory trend of the main monetary and financial variables.

The means of payment (M2) for November reached a monthly average balance of ARS 159.470 million, growing by 14.1 percent y.o.y. This trend shows that we are about to accomplish with the ones for the last quarter of 2008, thus complying for 22 consecutive quarters with our monetary aggregate targets. In December, total means of payment are likely to be between the midpoint and floor of the target set.

In turn, by year-end, private sector means of payment will fluctuate around 9 percent. This figure is below the lower limit of the 2008 monetary program target due to a steeper-than-anticipated decline in the demand for money. This came about because, when the range was established, the strength and magnitude of the adverse shocks that affected the demand for money throughout the year were unforeseeable. Particularly important was the uncertainty caused by a markedly deteriorated international scenario, which led to a change in the composition of the citizens' investment portfolio. The outflow of funds, with capital taking shelter exclusively in US Treasury bonds, had a strong impact on emerging economies as a whole. Latin America was no exception. In perspective, the portfolio investment capital flow in Brazil, for instance, decreased by 75 percent against the previous year. In September and October alone, Brazil showed an investment capital outflow of almost USD 10 billion. Against this backdrop, virtually all central banks in the region had to actively intervene in the foreign exchange market to reduce pressure on their exchange rates and prevent a feedback loop from the plummeting on the domestic demand for money. Thus, the two largest economies in the region have sold around USD 30 billion in the spot market. Meanwhile, medium-sized economies, such as Peru, have sold almost USD 6 billion in order to stabilize their money markets as from October. Moreover, most central banks in the region have supplemented this generalized direct intervention with strong operations in derivatives markets, especially in the form of swaps. This explains why the private sector demand for money was below our calculations.

Given this new scenario, which I will thoroughly address in a few moments, one can see that any action towards forcing the trend of this monetary aggregate to comply with expectations but under very different international conditions would have been more detrimental than beneficial for the economy as a whole. Finally, the wider aggregate in pesos (means of payment plus time deposits, or M3) is expected to reach an annual growth rate of 14.7 percent by year-end.

In spite of persistent volatility in international markets, domestic demand for money has recovered as from the second half of November. In fact, M2 grew by 1.4 percent throughout November, whereas M3 increased by 0.9 percent.

Bank funding to enterprises and households continues to grow, although at a lower pace, against a background of limited credit risk. Loans to the private sector in pesos were expected to grow by about 25 percent in 2008, and account for 12 percent of GDP, anticipating a considerable potential for growth in years to come. Consumer loans and credit card financing show annual growth rates of around 35 percent, which places them among the most dynamic lines. Funding to businesses is still increasing in all productive sectors. Loans to trade, industry and services sectors grew above average, with a higher share in overall funding. Policies implemented by the Central Bank to favor lending, combined with a favorable macroeconomic framework, have taken household and corporate financing to around 40 percent of total assets in 2008, almost 4 percentage points higher in y.o.y. terms.

This took place against a backdrop of a historically low nonperforming loan portfolio (2.8 percent of loans to the private sector). Nonperforming loans fell more than half a percentage point during the past 12 months due to corporate sector financing.

The counterpart of the increase in funding to the private sector has been the trend of the system exposure to the public sector, which dropped by 3.3 percentage points of assets in 2008. It has already accumulated a 27.5 percentage point drop since late 2004, and is now 14 percent below total assets. These figures – which represent a third of total loans to the private sector – are in line with those for other countries in the region. Setting a general ceiling of 35 percent of assets and a maximum limit based on financial institutions' capital and for different jurisdiction, and unbiasing minimum capital requirements, among other actions, allowed us to reverse the crowding-out of loans to businesses and households. Furthermore, if we take both deposits and loans into account, the Government has now become a net creditor of the banking system.

One of the main structural reforms of recent years has been the establishment of a regulatory framework preventing currency mismatches (with peso-denominated assets and liabilities and a lender of last resort that lends in pesos as well) and maintaining prudence when introducing financial innovations. Only 12 percent of deposits are currently denominated in foreign currency, and funding is limited to those who can prove repayment capability in the same currency. Our system is not funded with foreign resources (these only amount to 4 percent of liabilities): peso-denominated deposits are the main source of funds for local banks in times when the international financial conditions prevent them from getting resources through the capital markets. After growing at a 22 percent annual rate in the past four years, private sector placements have come to account for 49 percent of the system's funding.

In turn, rediscounts granted due to illiquidity during the 2001 crisis have virtually disappeared from the banks' balance sheets (and they represent only 0.3 percent of financial system liabilities). There remains only one institution, out of the 24 that had borrowed under these conditions, that is repaying its liabilities. The accumulated amortization of court-ordered payments to depositors derived from asymmetric pesification amounts to around 93 percent of such orders, the outstanding balance representing 0.2 percent of total assets.

Even in a markedly deteriorated global economic and financial framework, our system enjoys high liquidity and solvency, mainly because of prudential regulations. Cash equivalents represent around 40 percent of total deposits. During 2008, banks' liquid assets (including the LEBAC and NOBAC position) have increased over one percentage point of total assets.

As opposed to the trend in the developed world, institutions have virtually doubled their net worth in the past five years. As a result of Central Bank action, short-term fluctuations in asset prices did not impact on financial intermediation, and turbulences only affected banks' balance sheets moderately. Thus, we are about to achieve four consecutive years of positive systemic profitability. Profits from banking activity, together with new capital injections by financial institutions, boosted a readjustment of solvency.

Finally, the system is backed by a strong Central Bank in terms of its capital. Current reserve levels are historically high and cover over 65 percent of private M3 (vis-à-vis less than 40 percent before the 2001 crisis). These levels are also 10 percentage points higher than they were by the end of 2004. The same happens if we consider the coverage ratio against Central Bank liabilities. This strength facilitates the conditions to stabilize the demand for money, one of the monetary policy priorities during the past few months, in order to minimize the impact of shocks on domestic savings and credit.

### 3. The pillars of the monetary regime

The actions I have described so far are not about a change of policy – they are about applying the strategy of the past few years under a different scenario. This is a monetary-financial regime that factors in the idiosyncrasy of the Argentine citizen who, in the past two decades, has faced hyperinflation and seizing of deposits twice, among other crises. Therefore, we have chosen a policy approach that consists in the early adoption of prudential and countercyclical measures to reduce the vulnerability of the economy in the face of a changing scenario.

The risk management approach to monetary policy seeks to prevent disruptions in the money and financial market from spreading to the rest of the economy and affecting macroeconomic sustainability. Under this scheme, we take into account scenarios that traditionally involve high likelihood of having adverse effects. This entails the development of action guidelines in case such scenarios come true. At the same time, it entails preventive action to reduce their likelihood or minimize their potential impact on the economy. In our country, the strategy jells due to the consistency and validity of its three main pillars: (1) a robust monetary policy that ensures the equilibrium between supply and demand in the money market; (2) a countercyclical scheme to mitigate vulnerabilities and reduce macroeconomic volatility; and (3) a managed float.

The trend evidenced by the means of payment in 2008 reflects our prudence. And so do financial regulations, which aim to prevent the growth of credit from being hampered and jeopardizing the sustainability of the system. This balanced trend of the means of payment was observed against a framework of multicausal inflation that requires coordinated action by the economic policy and its different areas – fiscal policy, wages policy, income policy and monetary policy. In a context of international commodity prices falling, performance in 2008 confirms the effects of this joint action. Bearing in mind the stage that Argentine economy currently undergoes and the instruments available, overemphasizing only one policy would be a proof of short-sightedness. Especially in a phase where we are still lacking many tools that are typical in more developed economies. For instance, monetary policy transmission channels are only just being rebuilt, since credit to the private sector accounts for only 12 percent of the economy, still far below the Latin American average. There are many examples in Argentine history of monetary regimes unsuccessfully shifting from one extreme to the other given it inconsistencies. The relatively stable periods were short due to contradictions in the programs that should have ensured macroeconomic solvency. Suffice it to recall the end of price stability in the 1990s, after a sharp appreciation of the domestic currency resulting from an exchange rate that was inconsistent with the fiscal position and external equilibrium.

Among the preventive measures, the reserve accumulation and management policy acts as an insurance against temporary changes in external financial conditions. This is a strategic option – not only a by-product of the managed float, but a prudential policy in itself. Among other advantages, such a policy ensures macroeconomic stability, enhances confidence in the domestic currency, and reduces the impact of external shocks as well as the cost of public and private financing. While this insurance policy is generally a less visible benefit, in cases of stress recalling to it provides specific advantages in terms of financial and monetary stability, as we could see in the recent critical episodes.

Finally, one more thing about the managed float. Since several studies outlined the theoretical basis and macroeconomic implications of these kinds of regime three decades ago, their use has been growing among emerging countries. Indeed, early research on exchange rate management came into being as a result of the collapse of the international monetary system devised at Bretton Woods, where a sort of peg was established between the various world currencies and the US dollar as the gold standard currency.

Empirical work expanding and fine-tuning the analysis of many scholars showed that several developed and emerging countries can be considered “managed floaters.” Less than a half of inflation targeting countries effectively apply a pure float. In this sense, the literature states that the reaction functions of central banks in inflation targeting emerging countries have a significant coefficient for the nominal exchange rate. This means that the exchange rate is an important variable for monetary policy conduct.

There are several reasons to avoid sharp fluctuations in the domestic currency and to mitigate excessive volatility, above all in developing countries with a limited capacity to absorb external resources through their capital markets. By mitigating fluctuations around a trend, this regime combines the needs of the various segments of the economy while preserving consistency with the whole of economic policy. Recent literature in foreign exchange matters factors in segmentation of and restricted access to financial markets into the analysis. The most relevant conclusions suggest that, in terms of maximizing social welfare, the best choice is a less flexible foreign exchange regime with more limited access to hedge instruments. This argument becomes more convincing where there is nothing like an international monetary system and a weakening economy in the country with the main reserve currency in the world.

This is the most realistic conceptual framework for the current stage at which our economy is. Furthermore, in our case – with a long tradition of pegs, high inflation, devaluation processes, runs to the US dollar, and a shallow capital market – it is necessary to “manage” the float as a transition towards a long-term stage.

In short, through the interaction of these three pillars, the Central Bank of Argentina boasts the adequate tools to provide two essential public goods that have been lacking in stress situations during the past 30 years. Through a set of robust policies to face various kinds of shocks, we are, for the first time in decades, in a position to provide monetary and financial stability to the Argentine people.

## 4. The international scenario

A year ago, when I presented the 2008 Monetary Program asserting that we would be facing the worst crisis since the Great Depression, many thought I was exaggerating. At that time, the economies were still growing at a historically high pace and commodity prices were showing an upward trend. Even though many expected a deterioration of the international scenario, few of us foresaw that the consequences would be as harsh as they have proven to be in the past few months.

The outlook nowadays is quite ominous. Every economy in the world is growing at a lower pace, and the main developed countries have fallen into a recession. Commodities reached their ceiling by mid-2008 and then started to plunge. Even today, they are lower that they were a year ago. The crisis affects both advanced and emerging countries, and is not showing any signs of finding a floor in the short term.

Throughout this year, financial trouble persisted, with a marked deterioration as from September. The international turmoil that was apparent since mid-2007 had initially been diagnosed as a liquidity shortage. Therefore, the main authorities in the world addressed it by essentially providing liquidity to the market. The threats to systemic stability, however, were evidenced by key institutions going bankrupt, which led to significant drops in asset prices. Growing concern over insolvency in various economic sectors has prompted action to rebuild confidence in the global financial system and to curb the damage to the real economy.

The current situation in the United States, for instance, shows some features that are characteristic of a scenario known in the economic literature as “liquidity trap,” such as that of the Japanese recession in the 1990s or the Great Depression. Recession and financial stability are coupled with a new challenge: flow deflation, where decreasing prices cause financial losses to enterprises and households by posing a relative increase in their liabilities. Such a scenario – characterized by short-term interest rates close to 0 percent (bonds and money being virtually perfect substitutes) and a low expansionary transmission of movements from the money supply to the other monetary aggregates, with banks reluctant to lend – is likely to spiraling up, pressuring on the Federal Reserve to a monetization of the financing.

On the backup of growing risk aversion, we saw in 2008 a widespread deterioration of financial assets in emerging markets. As in advanced economies, this was combined with a strong tendency towards the depreciation of domestic currencies against the US dollar. Thus, some countries had to increase their interest rates (for instance, Indonesia and Hungary) or stop the cutting cycle (for instance, South Africa, Turkey, and most of Latin America).

The better scenario suggests that developed economies’ activity would only start picking up slowly by mid-2009. In the meantime, emerging economies will face a significant deceleration, affected mainly through the trade channel (lower exports and international prices of our commodities) and the financial channel (capital outflows and credit constrains). This scenario is based on the assumption that the policies implemented will have their impact towards mid-2009. We expect the global economy to grow between 1.6 and 0.9 percent next year, which is far below our estimates of last year of 3.8 percent.

During the first part of the year, there was a widespread increase of inflation rates, affecting both advanced and emerging economies. The sharp drop in commodity prices since its peaks in July, together with economic deceleration, is nevertheless helping mitigate pressures. Inflation in developing economies is also moderating, although more gradually, due to persistent wage demands, the pass-through effect of recent devaluations, and still high inflationary expectations.

Commodity prices fell after July as a result of the financialization process experienced by these products. Yet, in the case of agricultural commodities, there are still certain structural factors that might act as a support for prices, preventing them from falling to early 2000s' levels.

Lower inflationary pressures and a weakening economy led to a monetary policy loosening in industrialized countries as well as some emerging countries. The bailout and capitalization of several financial institutions were supplemented by several fiscal stimulus packages ranging from selective tax cuts to increased public spending in infrastructure and subsidized credit lines for consumption. Central banks in the main economies responded via, among other actions, strong liquidity injections and reference rate cutbacks, thus changing the previous year's trend. These cutbacks entailed an abrupt return to record low interest rates. On the other hand, many countries extended the scope and the amount of government deposit guarantees, while some banking institutions were nationalized.

Against this backdrop, while advanced countries are having negative growth rates, emerging economies are expected to continue on a positive trend, though inevitably lower than in recent years.

Given the current framework and the growth dynamics of the global economy, it is fundamental to minimize the worldwide effects of the crisis – not only for the benefit of emerging countries, but also due to the urgent need for global growth. Let us not forget that, between 2003 and 2007, developing countries accounted for 75 percent of world economic growth (in purchasing-power-parity terms).

In line with action taken by the main economies, and given the deceleration of domestic demand and the expected fall of exports, we emerging countries are also implementing economic policies aimed at ensuring financial system stability and supporting domestic expenditure. So far, most governments have launched fiscal stimulus plans and credit facilities protecting productive sectors, to name a few, even though the adoption of new policies is not ruled out in the short term.

## 5. Monetary policy in 2009

### *5.1. The domestic economic scenario: macroeconomic forecasts*

The magnitude of the world economic crisis not only affects developed countries, but also emerging economies. In particular, the 2009 Monetary Program was developed on the basis of a still growing Gross Domestic Product, though considerably lower than that for the current growth cycle. Therefore, after growing at an average 8.3 percent in the past six years, with the economy expanding over 60 percent in cumulative terms since the end of the crisis, growth would be around 4 percent, due in part to stimulus measures taken by the Executive branch.

Considering that investment would grow at a similar pace to that of economic activity, it would still represent around 24 percent of GDP. This indicator is in line with 2008 levels, which were record high for the past 25 years. Investment will reportedly exceed capital amortizations once again, thus expanding productive capacity. Furthermore, domestic savings still plays a fundamental role in investment financing, reducing the exposure to external flow volatility.

As I said before, there has recently been a readjustment in international prices of the main export products that sets them more in line with its long term fundamentals. Financial turbulences and markedly weaker oil prices exerted downward pressure on the price of the main grains used in biofuel generation, which, in turn, reduced the costs of transport and agricultural production. Simultaneously, there was an increased estimate for world production and stock of the main grains, in a framework of a relatively unchanging demand. Despite the sudden drop, however, commodity prices are still at high historical levels.

Due to dwindling international prices, combined with reduced harvest and other factors, exports are projected to amount to USD 69 billion – a somewhat lower figure than that for 2008. Nevertheless, the trade surplus is expected to enable the current account balance to remain positive for the seventh year running, an unprecedented event in recent Argentine economic history.

In line with this macroeconomic scenario, prices are expected to grow at a lower pace. As we have already discussed, inflation in Argentina can be attributed to several factors and, thus, should be tackled from various fronts at once. In this sense, in the second half of 2008, inflation was kept in check through the joint efforts by the fiscal, wage, income and monetary policies, as well as the effect of lower international foodstuff and energy prices. For the coming year, we expect inflationary pressures to loosen up by the combined effect of policy actions and the international and domestic scenarios, which will be reflected on both wholesale and retail prices and on broader based indicator such as the GDP implicit price index. As to the Consumer Price Index for the Greater Buenos Aires Area (CPI-GBA) in 2009, the projection is 7 percent for the base case scenario.

### *5.2. The 2009 Monetary Program*

The design of the 2009 Monetary Program requires us to think of different scenarios for next year's economic trend. To this end, and in line with best international practices, the Central Bank combines the projections yielded by several models with the economic policymakers' judgment. On that basis, the Monetary Program envisages the interaction of all the relevant variables, allowing forecasts to be consistent with each other. There would be no point in setting a target exclusively based on the behavior of a single variable, without considering how it impacts on and is impacted on by others. In other words, "experiments" which concentrate on a single aspect of the economy without taking into account the consequences on the different actors and sectors should be avoided. But we cannot trust models alone. This brings the "expert's judgment" into the picture, to fine-tune projections in the light of their expertise in economic policy management beyond what theoretical schemes can capture. It is on the basis of this approach that macroeconomic and money demand forecasts are made to support the Monetary Program.

This policy framework is reflected in monetary aggregates trend for the last four years. If we take a look at the evolution of M2 since the Monetary Program was established we can clearly see three stages: a first one between 2003 and 2004 where money expanded at an above 30 percent year-on-year rate, against an economy that were growing way bellow that level. More recently, in 2005 and 2006 total means of payment grew in line with economic activity. Finally, in the last two years monetary growth was bellow nominal GDP, guaranteeing the balance between supply and demand for money. All of this is a proof of the commitment and action taken by the Central Bank towards monetary and financial stability in Argentina.

This commitment also motivates my decision for the last few years to enhancing and sustaining the improvement on the quality of our applied research, among other things. The Economic Research area was given a new hierarchy and equipped with appropriate resources, becoming one of the most important research centers for macroeconomics and monetary economics in both the public and private sectors in Latin America.

Thus, we have macroeconomic models to make short- and medium-term forecasts within a consistency framework. These include the study of the economy's main transmission mechanisms, which enable creating simulation exercises to assess the impact of economic policies. Furthermore, they allow us to include uncertainty in projections and simulate the effects of alternative policies. For money demand forecasts, a model has been proposed in which a set of economic variables explains the evolution of private M2 real balances. For an econometric estimate, we use vector error correction models which allow modeling long-term relations between series.

In addition, we have been improving two models for policy analysis and forecasting exercises. One of the models characterizes the dynamics of a small, open economy, describing the interaction between the main macroeconomic variables. The other one is a structural model, with several theoretical and practical innovations, which include a rule for monetary aggregates, the role of fiscal policy and the addition of net exports as a potential driver for growth. These models offer alternative macroeconomic scenarios on an annual basis (this being the Monetary Program time horizon), with monthly and quarterly frequency (since the Program's targets refer to the monthly average balances in the last month of each quarter), and relate to both public and private aggregates. They estimate the relation between various forms of money and relevant economic variables. Thus, money demand is expected to evolve according to the relevant economic scenario, taking into account the most probable value for such path, as well as a series of alternative paths.

Supported by this set of technical tools, and in the framework of an economy still in transition towards its long run path, the Central Bank's 2009 Monetary Program adds new tools to previous Monetary Programs. The aim is to provide citizens with increased certainty about current and future monetary conditions. In fact, while last year's elements were the private M2 annual target and total M2 estimates at 12 months sight, the 2009 Monetary Program also includes quarterly estimates of the private M2 aggregate. These aggregates are estimated for both 2009 and scenarios at 12 months sight will be released throughout the year.

Giving due consideration to the private sector movements allows for more focus on household and company savings and investment decisions, which can reflect on prices in the long term. For this reason, the introduction of private M2 quarterly estimates is a new concrete step towards the adoption of sophisticated monetary analysis that combine predictability for decision making with the flexibility needed for an optimal money market response to changing scenarios. Thus, the monetary market will continue to mitigate the negative impacts of the external crisis instead of spreading economic imbalances.

In this path of constant learning and perfection in the use of monetary tools, and taking into account the macroeconomic context described for 2009, targets were set on the grounds of a base scenario where the average M2 and private M2 y.o.y. growth in December is 15.3 percent and 16.5 percent, respectively. This scenario is circumscribed to a end of year range of between 8.7 to 17.8 percent for M2 and between 9.8 and 18.9 percent for private M2.

The increase in lending capacity, derived from the expected behavior of deposits and the evolution of public sector loans in banks' portfolios, is consistent with a private sector credit growth of around 30 percent. This would add to the possible lending capacity from other sources (capitalizations, income from financial margin and services, placement of negotiable instruments, among others). Part of the loan dynamics will result from the national government's active policy to boost consumption and investment, pursuant to recently implemented operations, using social security funds.

As a counterpart to the expected credit dynamics, the various monetary regulation instruments developed and improved by the Central Bank in the past few years will facilitate the provision of liquidity for the natural development of the economy. Currently, besides the traditional monetary policy instruments such as open market operations, repo transactions or changes in reserve requirements, we have a large stock of LEBAC and NOBAC which provide a real liquidity cushion, that can be used through automatic repurchase mechanisms, such as repurchases in the secondary market, or by simply partly renewing securities upon maturity.

Finally, the Monetary Program should be interpreted as a general guideline for monetary policy. This tool lays down general parameters of how monetary policy instruments should adapt to changes in the relevant macroeconomic variables (terms of trade, capital flows, inflation rate, output gap, among others). In particular, the program's bands are designed to absorb any moderate changes in the expected base scenario, offering certain flexibility, but they can turn out to be insufficient in case of substantial changes.

Furthermore, countercyclical financial policies will continue to be applied to manage international reserves, together with the development of a solid financial system with limited mismatches and managed float, which proved to suit the Argentine economy best. The benefits of this regime are magnified in the current context of international turmoil, where sudden capital movements and commodity price volatility affect the foreign exchange rates of our main trading partners and impact our terms of trade.

Nevertheless, in a framework of greater uncertainty, mainly due to the international crisis, through the 2009 Monetary Program and supplementary policies implemented if necessary, the Central Bank aims to offer a predictable monetary and financial environment for the development of economic activity.

To sum up, our risk-management approach enabled us to overcome with solvency a alleged low-probability scenario such as the three shocks to the Argentine economy in slightly over twelve months. We showed with actions, skill, soberly and efficiency, securing two essential public goods: monetary stability and financial stability.