banco central Chile

MONETARY POLICY MEETING

MAY 2024

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Monetary policy meeting No.305, held on 22–23 May 2024.

Present: Rosanna Costa, Governor; Stepanka Novy, Vice-Governor; Alberto Naudon, Board member; Luis Felipe Céspedes, Board member; Claudio Soto, Board member.

Present the Finance Minister, Mario Marcel.

Also present, Luis Óscar Herrera, General Manager; Juan Pablo Araya, Legal Counsel and Attestor; Elías Albagli, Monetary Policy Division Director; Ricardo Consiglio, Financial Markets Division Director; Rosario Celedón, Financial Policy Division Director; Gloria Peña, Statistics and Data Division Director; Michel Moure, Institutional Affairs Division Director; Markus Kirchner, Macroeconomic Analysis Manager; Enrique Orellana, Monetary Policy Strategy and Communication Manager; Sofía Bauducco, Economic Research Manager; Guillermo Carlomagno, International Analysis Manager; Felipe Musa, Market Operations Manager; Miguel Fuentes, Financial Stability Manager; David Kohn, Head of Massive Information Analysis Department; Andrés Sansone, Advisor to the Finance Minister; Erika Arraño, Senior Economist; Marlys Pabst, Secretary General.

1. Background

The international scenario

On the external front, world inflation had been declining steadily, although it had moderated its pace due to the high persistence of services components. In the United States of America, after a succession of upward inflationary surprises during the first quarter of the year, the April figure had revealed a deceleration of core inflation. In the Eurozone, inflation continued to subside, favored mostly by goods, and was slowly converging to the target. In Latin America, both headline and core inflation had generally dropped further, although its decline had slowed down due to some reversal in energy prices and the stabilization of goods inflation. All of it in a context of inflation expectations remaining above the target in several economies in the region, with the exception of Chile.

This was taking place while economic activity and prospects that had remained contained, beyond some signs of an upturn earlier this year. In China, activity had accelerated in the first quarter 2024, while investment maintained marked heterogeneity between the deteriorated residential sector and the progress displayed by the other sectors, while consumption remained weak. Expectations for the rest of the year for the Chinese economy had not changed much with respect to forecasts in our March Monetary Policy Report (IPoM). The Eurozone had shown signs of a recovery, aided by services, while the manufacturing

industry continued to linger behind. The U.S. remained the exception, as its economy remained resilient, favored by dynamic domestic demand due mainly by services consumption. Meanwhile, the labor market remained strong throughout the first quarter; job creation, after several months posting rises unexpected by the market, had shown signs of moderation in April.

In this scenario, doubts about when the Fed would begin reducing the interest rates were the main factor behind the movements of global financial markets. Upward surprises in inflation, activity and the labor market in the U.S. economy had driven the markets to revisit their predictions about monetary policy, assuming that the rate cuts this year would be smaller than they considered in March. Compared with the April Meeting, long-term interest rates and stock markets had increased moderately in several economies. The global dollar, despite fluctuations, remained at similar levels-.

As for commodities, worth noting was the substantial increase in the copper price, to nearly US$4.9 per pound (+22% since the April Meeting). This evolution would have been related to news about supply constraints, which contrasted with still strong demand associated with copper usage for the energetic transition. Oil was trading at around US$81 per barrel (WTI-Brent average), which represented a fall of around 6% since the April Meeting, due to a relative stabilization of geopolitical conflicts and weak demand for gasoline in the United States. The prices of cereals had risen, largely because of weather phenomenon that affected the supply outlook.

The domestic scenario

On aggregate, March and April inflation had been in line with forecasts in the March IPoM. Thus, the annual CPI variation —spliced benchmark series— was 3.5% for both headline and core inflation—the latter being the CPI without volatiles. As for inflation expectations two years ahead, both our Economic Expectations Survey (EEE) and Financial Traders Survey (EOF) stood at 3%.

First-quarter National Accounts showed that, overall, the economy had performed in line with forecasts in the March IPoM. In deseasonalized terms, GDP had grown 1.9% with respect to the previous quarter, a result to which mining, trade and some services had contributed significantly. In annual terms, GDP variation was 2.3%. On the demand side, quarter-on-quarter consumption had risen again. Gross fixed capital formation variation was almost flat. The labor market behaved consistently with the trajectory of the cycle, the unemployment rate stood at 8.7% in the moving quarter ending in March, while the labor force was expanding steadily. Wages were still on a recovery path. The expectations of businesses (IMCE) and households (IPEC) remained pessimistic, beyond marginal changes in opposite directions.

In the Chilean financial market, movements of both long-term interest rates and stock prices matched those of its international peers. In turn, the peso had appreciated more than other comparable currencies and had strengthened around 8% against the dollar. This evolution owed mainly to the higher copper price, among other reasons.

Regarding credit, our Bank Lending Survey for the first quarter 2024 reported that lending conditions offered by banks showed no significant change from the previous quarter, while demand for credit was perceived to be weaker. In that context, real consumer and commercial loans posted changes of –1.3% and –3.7% in April, respectively. In the housing segment, credit showed limited growth, at 2.6% in real annual terms in the same month. Lending interest rates, especially short term, continued to reflect the pass-through of the cuts to the monetary policy rate (MPR), although at different paces. Mortgage rates, more closely related to long-term credit, remained high, while delinquency remained high in every portfolio.

Both the EEE and the EOF surveys, combined with prospects implicit in financial asset prices reflected expectations that, at this Meeting, the MPR would be reduced by 50 basis points (bp). In turn, while the EEE anticipated that the MPR would be at 4.5% in one year, the EOF and the forward curve placed such expectation at 4.75%.

2. Background analysis and discussion

It was mentioned that the world economy had performed relatively in line with assumptions in the latest IPoM. The biggest news was the sharp increase in the price of copper, which had traded above US$5 per pound, but had shown some declines in the last few days. It was noted that said copper price hike could lead to revisions in the external boost to the Chilean economy. This assessment, however, required careful analysis of the degree of persistence of this shock and also of the pass-through mechanisms to the domestic economy. In the short term, the lower exchange rate could ease inflationary pressures. Into the medium term, this could be more than offset by the greater dynamism of activity. Overall, careful evaluation of the economy's responses was also needed, as these could be different from what had been the case in the past, particularly during the commodity super-cycle of the early 2010s.

It was noted that, aside from the potential impact of the copper price increase, there were other elements to review to yield a correct estimate of the inflationary pressures the economy would encounter with two years. On one hand, there was the dynamic of investment and credit, both of which were evolving in line with forecasts, but continued monitoring was required. It was mentioned that the first technical report of the National Energy Commission, which implemented the law to stabilize electric power rates enacted in late April, would be known almost simultaneously with this Meeting taking place. Preliminary antecedents did not rule out the possibility of several increases in rates, which would be greater than those considered in the current central scenario, so its implications would have to be carefully evaluated in the next IPoM.

The discussion turned to the interest rate structure that prevailed in the market and whether it was consistent with the monetary impulse that the economy required. At the time of the Meeting, the market curve signaled a string of limited cuts that would place the MPR at 5% at the end of 2024, to then stay at 4.75% throughout the policy horizon. In real terms, this involved a rate above the ceiling of the current

neutral MPR estimate range, a situation that needed to be analyzed. Several reasons were brought up to explain why this could be happening, including a different assessment of the neutral MPR and the expected monetary policy trajectory of the U.S. Federal Reserve.

3. Analysis of monetary policy options

All five Board members agreed that information received since the last Meeting indicated that further cuts to the MPR were needed. The macroeconomic scenario was evolving in line with assumptions in the March IPoM, so the monetary policy strategy communicated at that time remained in effect. In this scenario, all the Board members considered 50bp and 75bp cuts to be plausible options.

There was consensus among the Board members that both options met the need to continue reducing the MPR, thus reflecting the economy's progress in resolving the significant macroeconomic imbalances and the process of inflationary convergence. Still, given its coherence with the March central scenario, the option of lowering the MPR by 50bp clearly dominated when the two alternatives were contrasted.

Furthermore, the 50bp-cut option had the great advantage that it was widely expected, so it would cause no significant changes in market prices. It was emphasized that adopting this decision did not imply that the Board followed the market to make its decision. Quite the contrary, it had been market expectations that had adjusted to the Board's communication in the March IPoM, with an MPR corridor that contained a reduction of that magnitude in the central scenario. Therefore, lowering the MPR by 50 bp only reinforced the previous message, which the market had made its own after the publication of the Report.

4. Monetary policy decision

Governor Costa, Vice-Governor Novy and Board members Naudon, Céspedes and Soto voted in favor of lowering the monetary policy interest rate by 50 basis points, to 6%.

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