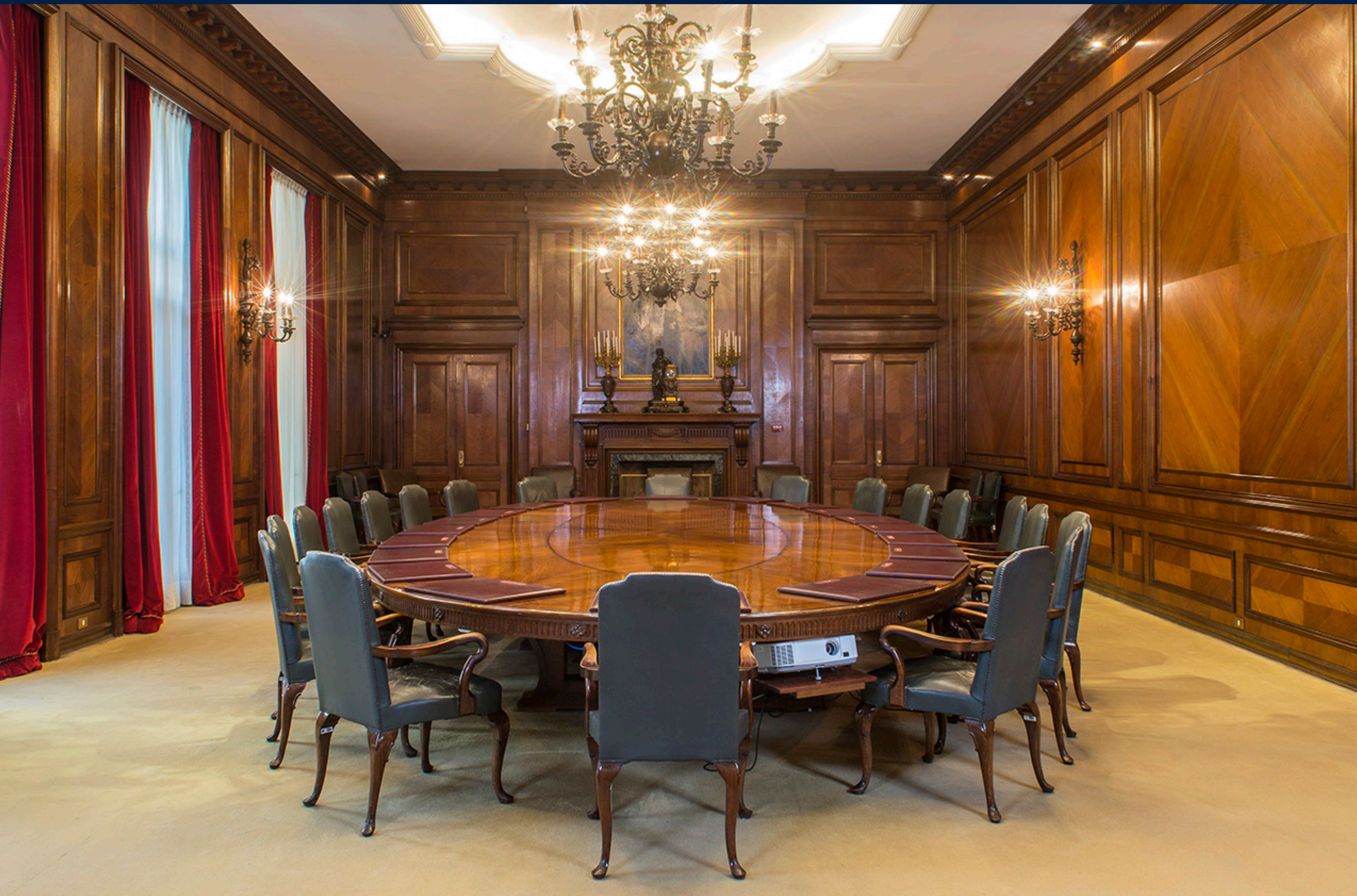
banco central Chile

MONETARY POLICY MEETING

JULY 2024



MONETARY POLICY MEETING

Monetary policy meeting No. 307, held on 30-31 July 2024.

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

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 Real, 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, global inflation had generally continued to decline at a moderate pace, mainly due to a slow decline in the services components. In the United States, June's inflation had been below expectations and the labor market was showing signs of moderation at the margin, including only modest job creation. This had turned the market's outlook for the Federal Reserve (Fed)'s monetary policy somewhat less contractionary.

In the Eurozone, total inflation had receded as expected, although its core component had remained unchanged compared to May and exceeded projections, in a context where the inflationary dynamic of the region had shown some volatility in recent months due to one-off events.

In several Latin American economies, inflation had tended to stabilize. On one hand, the widespread rebound of food prices in the region, partly influenced by the lagged effects of the El Niño phenomenon. On the other hand, core inflation had fallen, along with the prices of goods, in a scenario of no significant slack in the labor markets.

About activity, second-quarter growth had accelerated in the United States exceeding market forecasts. Every component of domestic demand had contributed to boost growth in the country, with a noteworthy contribution of private consumption. This situation contrasted with the limited pace of growth observed in the rest of the world, especially due to a greater-than-expected slowdown in China in the second quarter. This was explained, in large part, by the weakness of consumption, while investment had continued to show a disparity between the deteriorating residential sector and a more favorable evolution of investment in manufacturing and infrastructure.

In the Eurozone, high-frequency activity data for the second quarter showed signs that the bloc's economy was growing, but at a somewhat slower pace than in the preceding quarter. Monthly Latin American indicator had maintained their dynamism and suggested that the rebound observed in the first quarter would continue going forward. Overall, growth prospects had not changed significantly for 2024-2025.

As for global financial markets, compared with the previous Meeting, long-term interest rates had seen some decline in both developed and emerging economies. The stock markets had shown mixed movements and the global dollar had appreciated.

In general, commodity prices had dropped since the last Meeting. The drop in metals responded partly to somewhat weaker signals from China, along with other elements such as a lower momentum associated with the energy transition in developed economies and some positive supply-side news. Thus, although with fluctuations, the price of copper had decreased with respect to the June meeting. The price of a (WTI-Brent average) oil barrel was around US$79 in the days prior to the Meeting (-5% since the June Meeting). Food prices had remained fairly stable during June, although there had been significant falls for some grains due to a more favorable outlook on the supply side.

The domestic scenario

In June, headline inflation had been in line with forecasts in the last IPoM. The core measure --CPI without volatile items-- had varied less than expected, mainly in goods and due to factors that were estimated to be transitory. Among them, the occurrence of trade-related events that had a stronger than anticipated downward impact. On the volatile side, foodstuff prices had risen more than expected due to adverse weather events. Thus, the annual variation of the CPI --spliced benchmark series-- reached 3.8% and that of the core measure reached 3.2%. Regarding two-year inflation expectations, both the Economic Expectations Survey (EEE) and the Financial Operators' Survey (EOF) were at around 3%.

Local activity had performed below expectations in the June IPoM. In May, the non-mining Imacec had decreased 0.5% month-on-month in its seasonally adjusted series (+0.2% annually), a result that was largely explained by one-off supply factors, mainly associated with manufacturing and mining. June sectoral activity data (INE) showed a below-expected performance in some sectors.

On the demand side, high-frequency indicators pointed to no major differences with the projections of the last IPoM. The large-scale investment project surveys stood out, showing a significant increase in the amounts foreseen for the upcoming years. In the labor market, the unemployment rate for the moving quarter ending in June remained at 8.3%. Although still in pessimistic territory, the expectations of businesses and households had picked up somewhat.

In the local financial market, short- and long-term indexed interest rates had declined since the last Meeting, in a context where nominal rates had not changed much. The peso had depreciated, in line with a lower copper price. Meanwhile, the IPSA stock index had oscillated and had fallen a little sin the last Meeting.

Our Bank Lending Survey (ECB) for the second quarter of 2024 revealed that the lending conditions had been stable in most portfolios, while the demand for loans was still low in every segment.

Real consumer and commercial loans were still declining, with annual variations of -2.1% and -2.8% in June, respectively. In the housing segment, they maintained moderate growth (+2.3% in real annual terms in the same period). The rates of shorter-term loans continued to reflect the pass-through of MPR cuts, in line with the usual patterns. Delinquency rates continued to increase in the commercial and housing portfolios, while they decreased slightly in the consumer segment.

At this Meeting, the Economic Expectations Survey (EEE) median anticipated a reduction in the MPR of 25 basis points (bp), and both the Financial Traders Survey (EOF) along with the projections implicit in the prices of financial assets pointed to a pause. At one year, both surveys placed the MPR at 4.75%, while the forward curve saw it at 5%.

2. Background analysis and discussion

It was noted that, generally, incoming news since the last Meeting did not deviate from the trends assumed in the June IPoM. On the one hand, the economy was recovering, with demand being somewhat more dynamic than activity. On the other, the direct impact of electricity prices on inflation would be significant, but transitory. Moreover, the outlook for investment, especially in the mining sector, was picking up. Finally, the US inflationary cycle would feature a gradual convergence to its 2% target, suggesting that the America economy, which had been unexpectedly dynamic lately, was losing speed. This would allow the Fed to go ahead with its gradual process of lowering its benchmark rate, with one or two cuts of 25bp during this year. In this context, global financial markets will remain broadly unchanged, with long rates still high but with possible minor declines, and the dollar remaining strong.

In any case, it was noted that there were new developments whose impact was important to measure, as they could generate risks for the central scenario. On the external front, the weakness of the Chinese economy stood out, which contributed to a significant downward correction in the price of copper. If persistent, the Chilean economy could have a milder external impulse than contemplated in the IPoM, since the copper price, which was one of the factors behind the adjustment of the projections, not only because of its impact on mining investment, but also because of its consequences on expectations and the resulting effect on household spending, could have a greater impact on the Chilean economy..

At home, partial second-quarter data showed slower than expected activity. However, a more thorough analysis pointed to some specific factors in this result, while domestic demand performed relatively in line, albeit with a restructuring of domestic demand towards lower consumption and higher investment. Regarding inflation, the depreciation of the peso and the fact that the INE would not factor the subsidies associated with the electric bill hike into its CPI calculation, pushed up the inflation outlook for the second half of 2024 and the first half of 2025.

It was pointed out that the evolution of the macroeconomic scenario seemed to be generating relevant risks with opposing effects on inflation. On one hand, the risk that activity would turn out to be lower than expected, leading to lower inflationary pressures. On the other hand, there was a risk of greater inflationary persistence, in a context of higher levels of inflation in the short term associated with the rise in electricity prices.

It was argued that neither risk scenario was imminent and neither dominated over the other. Although activity was behaving below expectations, this was not the case with demand and some particular elements were identified. Meanwhile, the reaction of inflation expectations and interest rates showed that the markets had grasped the specific origin of the inflationary shock and its transitory nature. All in all, it was emphasized that this issue should remain under close scrutiny.

3. Analysis of monetary policy options

All five Board members agreed that the information at hand confirmed that, generally speaking, the economy was evolving in line with the trends depicted in the June IPoM's central scenario. Despite some important news regarding activity and the short-term inflation forecast that had to be considered, they pulled in opposite directions for the future inflationary dynamic. It was agreed that a more thorough analysis of the implications of these elements for monetary policy would be undertaken in the context of the next IPoM when more background information would be available to contrast these trends.

The Board agreed that it continued to consider the strategy outlined in the last IPoM to be valid, i.e., that the convergence of inflation to the 3% target was consistent with a policy rate that would be further reduced over the monetary policy horizon. Accordingly, they considered the most appropriate options to be (i) hold the MPR, or (ii) lower it by 25bp to 5.5%.

The Board agreed that the two options were compatible with the strategy proposed in the IPoM, noting that market expectations actually assigned fairly the same probability to both. Hence, choosing one or the other option required considering tactical aspects and the weighting of risks.

On the one hand, considering the central scenario of the June IPoM, it was reasonable to begin to make pauses in the MPR lowering process. In addition, given the fact that short-term inflation projections were being revised upwards, there was room to be cautious and wait for the next Report with more background information and a revision of the medium-term outlook. As for the decision to lower the MPR, conditional on the central scenario, making that choice now or at one of the following meetings was just a timing issue. However, lowering the rate at this Meeting would limit the leeway for the rest of the year.

Considering the related risks, it was noted that neither option clearly dominated over the other, and the data that would be known before the next IPoM would help to better gauge their implications.

4. Monetary policy decision

Governor Costa, Vice-Governor Novy and Board members Naudon, Céspedes and Soto voted for keeping the monetary policy rate (MPR) at 5.75%.