

Monetary Policy Meeting^{1/}

OCTOBER 2020

CENTRAL BANK OF CHILE



^{1/} This is a translation of a document originally written in Spanish. In case of discrepancy or difference in interpretation, the Spanish original prevails.

MINUTES OF THE MONETARY POLICY MEETING

Monetary Policy Meeting No. 277, held on Wednesday 14th and Thursday 15th October.

Present: Mario Marcel, Governor; Joaquín Vial, Vice-Governor; Pablo García, Board member; Alberto Naudon, Board member; Rosanna Costa, Board member.

Also present: Alejandro Zurbuchen, General Manager; Juan Pablo Araya, General Counsel and Attestor; Elías Albagli, Monetary Policy Division Director; Beltrán de Ramón, Financial Markets Division Director; Solange Berstein, Financial Policy Division Director; Gloria Peña, Statistics Division Director; Michel Moure, Institutional Affairs Division Director; Markus Kirchner, Macroeconomic Analysis Manager; Enrique Orellana, Strategy and Communication of Monetary Policy Manager; Miguel Fuentes, International Analysis Manager; Andrés Fernández, Economic Research Manager; Diego Gianelli, Market Operations Manager; Juan Carlos Piantini, Financial Market Analysis Manager; Rodrigo Alfaro, Financial Stability Manager; Francisco Ruiz, Macroeconomic Statistics Manager; Felipe Lozano, Communications Manager; Tatiana Vargas, Senior Economist; María del Pilar Cruz, Senior Economist; Marlys Pabst, Secretary General.

1. Background

The domestic scenario

August's Imacec posted an 11.3% annual fall in domestic activity in the month, contracting somewhat more than expected by the market, although with increasing speed compared to the previous month: 2.8% month-on-month in de-seasonalized terms. Sectors such as construction and services continued to show markedly negative annual variation rates, still affected by the quarantines that had been in place throughout the month. Mining had also underperformed in annual comparison, although production levels remained high. In contrast, retail had made significant progress and had gone positive in annual variation terms for the first time since February. This, in a context where consumption was being temporarily boosted by the partial withdrawal of pension savings and, to a lesser extent, by fiscal transfers. This had resulted in significant purchases of goods, important inventory depletion, and higher consumption-related imports. As for investment, various indicators—including wholesale trade, home sales,

construction expectations (IMCE)—had improved in the margin, despite being still low, in general.

The labor market had continued to show signs of stabilization. Employment and hours worked had seen an incipient improvement in the moving quarter ending in August, while wages showed no significant change. Both the Bank's online job ad index and hiring expectations (IMCE) had recovered partially. The above, together with the progress of the deconfinement process and the government's employment subsidy measures made it possible to foresee further progress in this area in the coming months. Business and consumer expectations had continued to recover, although still on pessimistic territory. The median of October's Economic Expectations Survey (EES) yielded an estimated fall in GDP of 5.5% this year, albeit with a high dispersion of responses.

Preliminary qualitative information, compiled through interviews conducted for the Business Perceptions Report (IPN), indicated that the outlook for activity was strongly associated with the temporality of the pandemic's cycle. Thus, improved conditions were observed in the North and a more depressed situation in the South. However, the withdrawal of pension savings and fiscal measures had caused effects across all regions and in several sectors and in the repayment of financial obligations. Regarding trade, a large number of respondents reported inventory shortages, increased demand and price hikes. However, most perceived this as a transitory effect. Respondents continued to report a high level of uncertainty, mainly associated with the resurgence of violence outbursts in the country. Business perceptions regarding the labor market were not as pessimistic as in previous months. There were reports of fewer layoffs in recent months and the return of employees covered by the Suspended Employment Law. In any case, for the following months increases only in the number of seasonal workers were foreseen because uncertainty held back new hirings. Moreover, the prevailing vision was that not all the layoffs due to the pandemic would be reversed.

Generally speaking, the behavior of local financial markets matched those abroad, with stock market losses and a depreciation of the peso. Special mention deserved the rise in long-term interest rates, which in the cases of BCPs and BCUs were up between 25 and 30 basis points from early September. In the money market, the cost of financing in pesos and dollars remained low, but with some increase in the latter. In this context, the Bank had announced at the end of September that it would lift the measures to mitigate the financial impact of the partial withdrawal of pension funds. Furthermore, on the day of the Meeting, the country had learned of Chile's sovereign risk rating downgrade.

Credit growth in the commercial segment showed less dynamism in the margin (9.5% real annual growth in September; 10.9% in August), while consumer loans showed a sharper contraction and mortgages posted a minor advance (-15.3 and 5.3% in real annual terms in September, respectively). In any case, commercial loans continued to grow above numbers of the beginning of the year, thanks to the strong impulse provided by the measures in place. Interest rates had fallen across all credit categories. Banks' applications for phase II of the Credit Facility Conditional on Increased Lending (FCIC) amounted to just over 30% of available funds. According to August data from the Financial Market Commission, bank delinquencies of 90 days or more had been declining for several consecutive months, with a recent reduction in portfolios associated with individuals. Provisions showed no big variations, and remained at their highest levels of several years.

The Bank Credit Survey of the third quarter reported tighter conditions for all types of loans, as higher risks were perceived in all segments. Meanwhile, household demand remained weak—for the consumer and mortgage segments—, related to the users' worsened income and/or employment conditions. Regarding corporate demand, the unrelenting deterioration of investment-related requirements was compounded with a fall in working capital requirements. Preliminary qualitative information gathered for the Business Perceptions Report showed that most of those consulted so far did not foresee any imminent financing needs. This was explained by their gained access to credit, their improved financial situation, their reluctance to increase their indebtedness in the face of perceived uncertainty, or because their applications had been turned down and they quit trying.

Since the last Meeting, annual inflation had risen to 3.1% and its core component (i.e. CPI without volatiles) had risen to 2.9%. This increase was mainly explained by the rise in the prices of goods and foodstuffs in September, which had brought the monthly variation in the CPI to 0.6%. This evolution was mainly in line with the temporary boost in consumption of goods linked to the withdrawal of pension savings and to some short-term supply constraints to meet this demand. Into the medium term, inflationary pressures remained contained. As for inflation expectations, they had been adjusted upward in the short term. At December 2020, the median of the EES was 2.4% per year. Meanwhile, one year ahead the median had risen to 2.7% per year and that of the Financial Traders Survey (FTS) to 2.5%, while two years ahead it remained around 3%.

In this context, expectations for the monetary policy rate (MPR) implicit in financial asset prices and included in the surveys (EES and FTS) continued to point to the rate being kept at 0.5% for a prolonged period of time.

The international scenario

On the external front, incoming data pointed to some moderation in the pace of economic recovery, especially in developed countries. This was visible in indicators such as manufacturing output, services and retail sales, as well as in the PMIs. The fundamentals of private consumption were still weak, particularly consumer confidence and labor market indicators. After the previous Meeting, there had been no major developments in fiscal support programs, and the few announcements that had been made entailed a reduction in previously adopted stimulus measures. This, in a context where knowledge had been gained in handling the pandemic, which allowed pacing the containment measures despite increases in infections, as a better control of its effects had been gained.

In the emerging world, the dynamism of activity and demand variables in China were worth noting, including investment in fixed assets—state-owned and private—, foreign trade, retail sales and business prospects. In Latin America, economic recovery was lagging, reflecting quite diverse epidemiological, economic and social realities, which also reflected differences in countries' policy responses. Although market projections for global growth this year had not changed much, their composition did show changes, with better prospects for developed economies, especially the United States, and a deteriorating outlook for emerging economies. With respect to commodity prices, copper had remained at around US\$3 per pound and oil had fallen to around US\$40 per barrel.

The financial markets had seen more episodes of volatility. With respect to the previous Meeting, stock markets had shown some falls, currencies had depreciated across the board with respect to the dollar and risk premiums had been slightly reduced. Credit had been decelerating in some economies and corporate risk remained contained. However, the risk of the possible consequences of high corporate indebtedness had risen. Monetary incentives from central banks remained high, while many policymakers had reaffirmed their commitment to keep them in place, scale them up and/or adopt new measures if necessary.

2. Background analysis and discussion

Commenting the macroeconomic scenario, it was agreed that, in general terms, the bulk of information indicated that both the global and local economy had evolved in line with forecasts in the September MP Report. In general, activity in Chile and many other countries was on a recovery path, thanks to the momentum provided by the various economic policies implemented and

the sanitary management of the crisis. Still, it was mentioned that clearly the evolution of the economy was and would continue to be closely linked to steps forward and backward in the control of the pandemic. This raised a note of caution, because while some countries had significantly reduced the number of cases, others were struggling with a significant increase.

There was consensus that the set of risks remained very important, and their implications were generally negative. On the external side, in recent weeks uncertainty had resurfaced regarding the evolution of the pandemic, both because of the increase in infections in Europe, the scars it was leaving on economic activity, and also regarding the possibility of having a vaccine widely distributed in a relatively short period of time. There were also several important political risks, such as the elections in the United States, the Brexit unfolding in Europe and other sources of recent geo-political conflict.

Locally, the data on activity, demand, employment and inflation had shown some differences with forecasts, with different signs and uncertain persistencies. It was noted that the data suggested that the worst of the pandemic had been left behind, and that the negative surprise of August could be due to a delay in opening compared to what had been anticipated in the September MP Report. Incidentally, doubts remained as to when to expect the economy to recover. This was especially visible when considering that part of the increased dynamism of demand was associated to transitory effects, such as the impact of the withdrawal of pension savings and increased fiscal transfers, among others. In fact, these same factors would explain the unexpected rise in some prices, which suggested that the medium-term outlook continued to be one where downward inflationary pressures predominated, along with capacity gaps that would continue to be substantial in the coming quarters.

The evolution of political risks was another factor of concern both globally and locally. In many countries, the Covid-19 shock had caused considerable stress on society and its authorities, whether through advances and setbacks in fighting the pandemic, the imposition of sanitary measures and the implementation of compensatory economic policies. In Chile, this phenomenon was accentuated by the preceding social crisis, the high level of distrust in some institutions and the tensions between government branches. It could not be ruled out that these phenomena were affecting the price of some Chilean financial assets. Although the CDS and EMBI had declined since the last Meeting and long rates stood at low levels, it was undeniable that, as of the second quarter of this year, the dollar and longer-term interest rates were on an upward trend. The important correction of the stock market stood out, as it had fallen more than that of other comparable economies. In addition, while the Meeting was

taking place, the country had learned of the downgrading of its credit rating by a risk-rating agency, a correction that was expected by the market and reflected, in the agency's statement, the weakening of public finances caused by greater spending pressures in the wake of the social outbreak and the pandemic. It was further noted that in the current context it was difficult to discern how much of the movement of long rates was due to rather transitory phenomena and how much to more persistent factors, for which the policies of the Central Bank had little capacity to reverse.

At the opposite side, it was noted that some of the risks had evolved positively. On the one hand, for the first time in several months, positive numbers had been achieved in job creation, and at the same time administrative data suggested that the impact of the crisis on salaried employment had been somewhat less than estimated. This, coupled with the announcement of the employment subsidy program, somehow mitigated the risk of a further worsening of the labor market. Another important element was the fact that the expected inflation measures had moved away from the levels that could cause concern for the anchoring of expectations, partly because of the surprise of September, which also reduced one of the risks considered a while back.

3. Analysis of monetary policy options

All five Board members agreed that, the same as in previous meetings, the macroeconomic context produced by the pandemic only stressed the message that monetary policy would continue to be highly expansionary for a prolonged period of time. This meant keeping the MPR at its technical minimum for several quarters and the prevailing unconventional measures in place. Towards the medium term, all the Board members agreed that it would be essential to be on the alert for events that could generate instability in the financial markets, reacting in an effective and timely manner.

4. Monetary policy decision

Governor Marcel, Vice-Governor Vial and Board members García, Naudon and Costa voted for holding the MPR at 0.5%. They also agreed to keep in place the unconventional measures to support liquidity and credit, furthering the current asset purchase program. In addition, should the evolution of the economy would so require, they would continue to explore options to adjust said impulse and lend support to financial stability.