Monetary Policy Meeting[1]/

JUNE 2020

CENTRAL BANK OF CHILE

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

MINUTES OF THE MONETARY POLICY MEETING

Monetary policy meeting No. 274, held on 16 June 2020.

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

Present the Finance Minister, Ignacio Briones.

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; Rodrigo Alfaro, acting Financial Policy Division Director; Gloria Peña, Statistical Division Director; Michel Moure, Institutional Affairs Division Director; Markus Kirchner, Macroeconomic Analysis Manager; Enrique Orellana, Monetary Policy Strategy and Communication Manager; Miguel Fuentes, International Analysis Manager; Diego Gianelli, Market Operations Manager; Felipe Lozano, Communications Manager; Luis Óscar Herrera, Advisor to the Finance Minister; Marlys Pabst, Secretary General.

1. Background

The evolution of the Covid-19 pandemic and the actions taken to contain it presented an unparalleled, massive shock on the global economy. Its immediate impact was severe, it was lasting more than previouly expected and its long-term repercussions were still uncertain. The whole situation had deteriorated activity and employment beyond the forecasts of only a few months back, with a high degree of uncertainty regarding the unfolding of the pandemic and the best strategies to fight it. No country in the world had been spared, so most of them were experiencing significant drops in activity this year. Chile was no exception, and foresaw for 2020 the greatest contraction in 35 years. In this context, the main components of domestic demand had seen major setbacks while inflationary pressures had fallen dramatically.

The authorities had devised unprecedented responses to this scenario, using the policy space built over decades of responsible macroeconomic and financial management. The Board had taken the MPR to its technical minimum, and had adopted several measures to ensure liquidity provision and incentives to credit and, at its May Meeting, had committed further non-conventional measures should the evolution of the economy so require.

2. Background analysis and discussion

The discussion focused on how the macroeconomic scenario was evolving in response to the pandemic, in particular the size and simultaneity of the drops in activity in several countries, plus the negative impact on the labor market. It was noted that some countries were already beginning to show some incipient signs of a recovery, but in any case the projections of only three months back had been largely exceeded, revealing a much deeper crisis.

In Chile, the effects were also strong, with a fall in the April Imacec in the order of 14%, and a dramatic deterioration of the labor market, which anticipated a very significant downturn in activity in the second quarter. These went far beyond the March forecast, precisely because the evolution of the pandemic had proved to be much worse than projected then. This was consistent with the containment measures, which had been more prolonged and had spread over an increasing proportion of the territory, which would take a toll on the pace of recovery, because the longer the freeze-up of economic activities continued, the worse the financial and asset situation of businesses, families and the government would be. As for inflation, it was striking that in practically every country it had been below its pre-crisis forecasts, even after correcting for the effects of the drops in oil prices.

One interesting aspect about the response to the pandemic was that, while sanitary approaches to dealing with it had been very different from one country to another, economic measures were becoming much more similar, at least in those economies that had fiscal and monetary policy space, mainly strong fiscal support programs to sustain household and corporate income, and very aggressive monetary policies, both conventional and unconventional. This had eased pressures on the financial markets, allowing asset prices to recover in line with falling spreads. In this regard, it was noted that the Chilean government had promoted several initiatives that involved a significant fiscal impulse, to which in the days prior to the Meeting the agreed Emergency Plan had been added. This plan considerably reinforced previous announcements, and its implications on activity and inflation had been preliminarily incorporated into the projections of the Monetary Policy Report.

There was agreement that the actions to provide liquidity and support the granting of loans, promoted by the Bank, the Finance Ministry and the Financial Market Commission (CMF) had not only succeeded in avoiding a fall in commercial credit, but had also allowed them to increase their rate of expansion at the margin. However, it was clear that while this would have been adequate to finance a large part of the bank credit needs in the March scenario, in the current scenario it was insufficient in view of the prolonged disruption of economic activities.

3. Analysis of monetary policy options

All five Board members agreed that, given the macroeconomic context caused by the pandemic and with the MPR at its current technical minimum estimate (0.5%), there could be no other option than to keep it unchanged while stressing the message that it would be held flat for a prolonged period of time, longer even than had been previously estimated.

They also agreed that there was conclusive evidence that the economy was requiring a stronger monetary stimulus that had to be implemented using unconventional measures.

About the type and scope of the unconventional measures to be implemented, one Board member remarked on the complexity of conducting monetary policy under exceptional conditions, since quantifying the necessary stimulus, as well as understanding its transmission to the economy, were different than they were in normal circumstances. He added that, in any event, with the policy toolkit currently available to the Bank, an appropriate strategy could be adopted, encompassing a range of possible transmission channels. In the view of this Board member, implementing a new phase of the FCIC would encourage a deepening of the counter-cyclical behavior of commercial credit. In this new stage, he continued, it was reasonable to recalibrate the parameters and modalities in order to increase the complementarity of this new FCIC with the existing guarantees in COVID loans, as well as to consider the role of non-bank credit intermediaries that depend themselves on bank financing. This can be complemented by a financial asset purchase program. This mechanism would allow, in principle, to reduce certain risk premiums in the capital market, facilitate portfolio rebalancing towards riskier assets, and directly provide liquidity to non-banking institutions, which nevertheless are important mobilizers of private savings.

One Board member noted that the various measures implemented had been very effective in maintaining very high levels of liquidity and very low risk-free rates associated with that liquidity. In his opinion, however, credit presented problems that went beyond liquidity, in particular the risks associated with the granting of loans. On the latter, he believed that problems still existed that were preventing such liquidity from fully materializing into increased credit. He added that the Bank's new measures could help at the margin to lower spreads and thus deal with the issue of risk, but would not necessarily solve it.

Regarding the magnitude of the new monetary stimulus, all the Board members agreed that some figure of up to 10% of GDP seemed consistent with what the economy needed to navigate this complex period, to allow inflation to converge to the target and to ensure financial stability. One Board member commented that while this figure seemed reasonable, the doubts surrounding these estimates were significant, particularly because they were made in a very uncertain environment. One Board member agreed that it was difficult to accurately measure the magnitude of the additional impulse, but said that there were several metrics that could shed some light, such as the Covid loans' outstanding balance that was still available and needed, the sensitivity of the total commercial credit stock to the flow linked to the FCIC, or the exercises regarding the financing needs of the corporate sector. In his opinion, a judicious review of this background suggested that an additional boost of up to 10% of GDP for the remainder of the year would ensure the objectives of price stability and normal functioning of the payments system.

4. Decisión de política monetaria

Governor Marcel, Vice-Governor Vial and Board members García, Naudon and Costa voted for holding the MPR at its technical minimum of 0.5% while strengthening the policy orientation, noting that the MPR will be kept at that level over the entire policy horizon.

At the same time, the Board decided to add an extra, unconventional boost of up to 10% of GDP by means of two measures. First, it agreed to open phase 2 of the FCIC for an amount of US$16 billion for a period of eight months. This program considers the strengthening of incentives for the provision of bank credit to small and medium-sized enterprises, and to non-bank credit providers. Second, it agreed to implement a special asset purchase program, in the amount of up to US$8 billion, over a period of six months. The latter will allow acquiring bonds from eligible issuers, in order to increase liquidity in the market, reactivate the bond market, reduce the cost of long-term borrowing, facilitate portfolio adjustments and strengthen medium-term inflation expectations.

All the Board members stressed the need to extend the Bank's powers and instruments to take action when confronting riskier scenarios, considering the high degree of uncertainty that still hovers over the spread of the pandemic, the performance of the domestic economy, and the dynamics of the financial markets.