banco central Chile

FINANCIAL POLICY MEETING

NOVEMBER 2023

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Financial policy meeting No. 4, held on 6–7 November 2023.

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

Also present: Juan Pablo Araya, interim General Manager; Mauricio Alvarez, acting Legal Counsel and Attestor; Rosario Celedón, Financial Policy Division Director; Elías Albagli, Monetary Policy Division Director; Felipe Musa, acting Financial Markets Division Director; Gloria Peña, Statistics and Data Division Director; Michel Moure, Institutional Affairs Division Director; Diego Ballivián, Corporate Risk Division Director; Miguel Fuentes, Financial Stability Manager; Gabriel Aparici, Financial Infrastructure and Regulation Manager; Rodrigo Alfaro, Financial Research Manager; Markus Kirchner, Macroeconomic Analysis Manager; Guillermo Carlomagno, International Analysis Manager; Enrique Orellana, Monetary Policy Strategy and Communication Manager; Sofía Bauducco, Economic Research Manager; Juan Carlos Piantini, Business Strategy Manager; Francisco Ruiz, Macroeconomic Statistics Manager; Silvana Celedón, Communications Manager; Bernardita Piedrabuena, Vice-President of the Financial Market Commission; Nancy Silva, General Research Director of the Financial Market Commission; Alejandro Puente, Advisor to the Finance Minister; Andrés Alegría, Head of Financial Policy Implementation Group; Marlys Pabst, Secretary General.

1.Background

a. International scenario

The world economy continued to perform poorly, with prospects for the coming years in line with assumptions presented in the September Monetary Policy Report (MP Report). The risks of the external macro-financial scenario had intensified since the previous financial policy meeting (RPF), due to the volatility and tightening of financial conditions in world markets and geopolitical uncertainty. Long-term interest rates showed a significant increase because of doubts arising around the fiscal outlook of the United States, and a global savings-investment balance that was perceived tighter for the medium term than it had been in recent years, among other factors. Meanwhile, a scenario was consolidating where advanced economies' monetary policy would remain contractionary for an extended period of time, adding extra pressure on lending conditions for emerging economies. The Chinese economy had worsened, because of the weaknesses in the real-estate sector that the announced fiscal measures had been unable to resolve. All this within a complex global geopolitical context that made the prospects for the world economy to continue to be an important source of risks. All in all, no new tensions have been observed in advanced financial systems, but vulnerabilities remained in some segments of the U.S. banking industry and non-bank financial intermediaries. In this context, the dollar had appreciated around the world and stock markets showed mixed movements.

b. Local scenario

Activity and demand performed as foreseen in the September MP Report. Worth noting was the stabilization of private consumption and the improved private savings, which continued to narrow the current-account deficit. However, financial market depth indicators remained relatively low by historical measures. Long-term rates had been aligned with international trends and showed significant increases compared with other emerging economies. The peso had depreciated following the global evolution of the dollar, the smaller interest rate differential, and the deterioration of the terms of trade.

For businesses, financial conditions and outlook had recently improved, while the default rate tended to stabilize. Thus, default-related risks concentrated in the trade, construction, and real-estate sectors, and in firms that opted to renegotiate their debts and/or get a FOGAPE-guaranteed loan. In the construction sector, the smaller firms were taking longer to recover their margins. The real-estate industry remained less dynamic and the sale of new homes showed a moderate recovery. Meanwhile, households faced less dynamic revolving credits and showed stable consumption and default rate, in a context of limited job creation.

The banking system continued to make progress in implementing Basel III standards in terms of solvency and liquidity requirements, which will involve banks to increase their capital adequacy levels towards 2025. This includes the possible application of Pillar 2 capital charges, resulting from the supervision process of the Financial Market Commission.

Banks maintained a good position in highly liquid assets and comfortable liquidity coverage ratios, which benefited bank management in the face of the end of the Credit Facility Conditional to Increased Lending (FCIC) in 2024. The FCIC collateral substitution program was developing normally, constituted mainly with Central Bank instruments. In addition, the use of Liquidity Deposits was being incorporated more intensively.

Credit dynamics were characterized by a contraction in banks' total loans, in line with lower activity, owing mostly to demand-side factors in a context of high uncertainty. Both the commercial and the consumer portfolios were falling more mildly, while housing loans growth looked more dynamic albeit with still low expansion rates. Lending interest rates were decreasing and the advances in the process of inflationary convergence could result in a boost to demand for credit. Meanwhile, according to the Bank Lending Survey, lending conditions for firms remained tight and demand remained weak. As for credit risk, banks were building up provisions, to be better prepared for possible increases in delinquencies.

Bank stress tests showed that the banking system was still resilient. Faced with a severe shock, with activity constrained because of an increase in funding cost and deteriorated financial conditions, losses due to materialized risks were stable compared with the previous six-month period.

In addition to this, the banking system had capital levels and buffers in excess of the regulatory requirements, profits and ongoing capitalization plans that allowed the banks to build up the Counter-cyclical Capital Buffer (CCyB) in the terms defined in May.

2.Analysis of vulnerabilities, risks and mitigators

With respect to the previous meeting, the fact that the risks of the external macro-financial scenario had increased stood out. The external risk maps showed a tightening of global financial conditions, more volatility, and more adverse signs coming from the Chinese economy. Short- and long-term interest rates had risen considerably, in response to the re-acceleration of the economy and inflation in the United States, and concerns about its fiscal position. Together with a complex geopolitical context, the global economic outlook continued to be an important source of risks. In a potential scenario of higher and longer-lasting long-term interest rates and a more protracted monetary contraction in the developed economies, the financial conditions facing emerging countries could tighten even further, and reversals in risky asset prices could not be ruled out.

At home, the resolution of macroeconomic imbalances continued to move forward, which put the Chilean economy in a better footing to face the deterioration of the world scenario. The decline of inflation and short-term interest rates coupled with a drop in corporate debt and a normalization of credit borrowers' financial indicators. However, the Chilean financial market had factored in the perception of higher global risk, resulting in an increase in long-term funding costs for all classes of agents. This was reflected in local risk maps, which looked generally stable, but showed some signs of increased stress in indicators associated to long-term rates and certain corporate spreads.

Bank credit continued to shrink, owing mainly to the lower boost from demand for commercial credit in the last year. Lending to households also showed low dynamism, especially in the consumer portfolio, while mortgage credit flows were moderating at the margin. The outlook for medium-term credit growth was somewhat better, recovering towards the end of 2024. All in all, it was worth noting that the banking system's balance sheet structure maintained limited exposure to an increase in long-term rates and had sufficient liquidity, provisions and capital to withstand severe stress scenarios. However, it was of utmost importance to continue to strengthen the banks' capacities to deal with adverse events and prepare for future challenges, such as the end of pandemic-related support measures, a possible intensification of credit risk and requisites associated with the convergence to Basel III.

A deterioration of external financial conditions posed to biggest risk for domestic credit borrowers and lenders. This reaffirmed the need to continue to take action aimed at strengthening the resilience and capacity of the financial system to cushion adverse events.

Meanwhile, preliminary assessments of the activation of the CCyB at last May's financial policy meeting indicated that there was no evidence of any significant effects in the anticipated credit trajectory. In turn, the fact that this buffer would enter into full force in May 2024 allowed to continue to monitor the scope of this tool and its interaction with other micro-prudential measures in progress.

3.Analysis of policy options

There was agreement among the Board that the risks in the external macro-financial scenario had increased from the previous RPF. Thus, the possibility of an extremely adverse event was still latent, which would entail a significant reduction in credit with the consequent risk of an amplification of shocks to the economy.

The numbers pointed to the credit market performing in line with the ongoing process of macroeconomic adjustments. Evidence gathered since the previous meeting allowed to conclude that the foreseeable costs associated with the implementation of this measure were limited, and no effect on lending conditions was perceived.

The Board agreed that the global increase in long-term interest rates had been significant, which could also be seen in the risk maps, particularly for the external sector. The Board observed that, domestically, the economy had made progress in restoring its macroeconomic balances and that vulnerability indicators showed no big change since the May financial policy meeting.

The Board deemed positive that, given the current external context, the domestic banking system had available this capital buffer, that could be released upon the authority's decision to support the resilience of credit in case of a severe shock hitting the economy.

In turn, precautionary motives that yielded the way to the activation of this buffer were estimated to be still present, but they did not seem to have increased enough to warrant additional action. One Board member noted that, the deterioration of global financial conditions reduced the room for and the desirability of applying other macro-prudential measures. They also noted that the decision at the May meeting had been made under more favorable financial conditions.

Regarding policy options, all five Board members agreed to maintain the decision adopted at the May meeting, that is, the requirement of a CCyB of 0.5% of risk-weighted assets as from May 2024 was the best option. This was warranted by a scenario where external risks had increased but no extreme event had come true.

Accordingly, the Board considered that maintaining the decision announced in May would allow reinforcing its preemptative nature and the resilience approach of the CCyB. The Board agreed that it was important to note that the banking system had sufficient capital to withstand scenarios of severe stress, as well as buffers exceeding the regulatory obligations and ongoing capitalization plans that would allow it to meet the CCyB in force.

Finally, all Board members deemed necessary to continue to monitor the international evolution of and debate about the use of CCyB and its interaction with other macro-prudential tools. The importance of further updating the CCyB policy framework was also brought up, in line with international best practices, considering the specific characteristics of the local banking system and the state of progress in the implementation of Basel III standards. The Board agreed to advance during the year 2024 in refining the analytical framework, which would include defining a neutral level.

4. Financial policy decision

Governor Costa, Vice-Governor García and Board members Naudon, Céspedes and Novy voted for maintaining the Counter-cyclical Capital Buffer at a level of 0.5% of risk-weighted assets, which will become enforceable in May 2024.

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