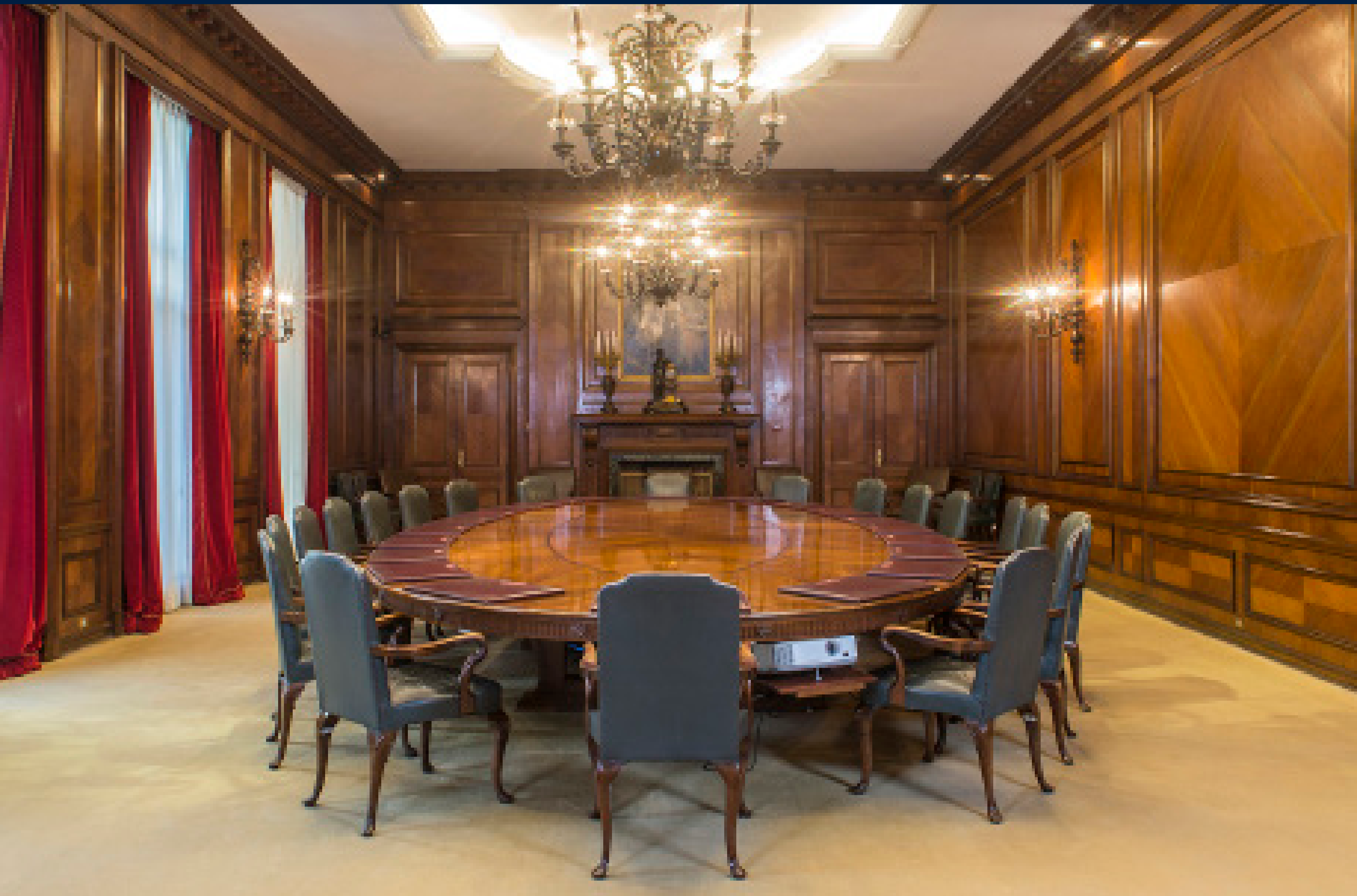
MONETARY POLICY MEETING

SEPTEMBER 2023



MONETARY POLICY MEETING

Monetary Policy Meeting No.300, held on 5 September 2023.

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

Also present: Beltrán de Ramón, 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; Diego Ballivián, Corporate Risk Division Director; Markus Kirchner, Macroeconomic Analysis Manager; Enrique Orellana, Monetary Policy Strategy and Communication Manager; Lucas Bertinatto, acting International Analysis Manager; Miguel Fuentes, Financial Stability Manager; Felipe Musa, Market Operations Manager; Silvana Celedón. Communications Manager; Andrés Sansone, Advisor to the Finance Minister; Marlys Pabst, Secretary General.

1. Background

In general terms, the macroeconomic scenario had evolved in line with forecasts in the June Monetary Policy (MP) Report. Although still high, inflation continued to decline, in a scenario of ongoing adjustment of activity and demand. At the same time, cost pressures had eased and two-year inflation expectations stood at 3%. In this context, the Board had begun to reduce the monetary policy rate (MPR) at its July meeting, lowering it from 11.25% to 10.25%.

Although the decline in inflation was a global phenomenon, its outlook differed from one country to another. Thus, while in some economies monetary policy was being less contractionary, in others a more prolonged than anticipated tightening was foreseen, particularly in the developed world. These divergences had been permeating global financial markets, with opposing movements in interest rates and the depreciation of an important group of currencies, the Chilean peso included.

The projections in the central scenario of the September MP Report contained few changes with respect to June's. GDP growth was foreseen between -0.5% and 0% in 2023. In 2024 and 2025, the economy would resume positive expansion rates, growing between 1.25-2.25% and 2-3%, respectively. Private consumption had stabilized and its projection was maintained, while investment was expected to contract somewhat less this year than had been anticipated in June. Headline inflation was expected to decline further, reaching 3% in the second half of 2024. Core inflation would follow suit in early 2025.

2. Background analysis and discussion

On the external front, it was noted that the growth outlook for our trading partners and the terms of trade did not change significantly with respect to projected in the June MP Report. However, it was noted that the external scenario did exhibit a change in composition that was worth analyzing. This originated in the resilience of the U.S. economy and China's more pronounced weakness. It was mentioned that, in case these differences deepened, the effects on the Chilean economy could be significant. On the one hand, a more contractionary interest rate trajectory in the U.S. resulting from a more dynamic economy, which would not generate the necessary conditions for the inflationary convergence, could trigger a major worsening of the financial conditions facing emerging countries. On the other hand, lower growth in China could hurt Chile's terms of trade and exports significantly. It was noted that, although the central scenario did not factor in this type of negative events, careful monitoring was required.

About the local economy, it was noted that the economy had been gradually resolving the macroeconomic imbalances of previous quarters and that inflation was falling, even somewhat faster than expected in the case of core CPI. It was added that, however, the most important change was in risks, since the likelihood of scenarios of a more marked deviation of inflation had decreased significantly. This was so mainly because the economy had been adjusting in line with projections, inflation expectations had been aligned with the two-year 3% target and, in general, the market's macroeconomic view had also been converging with the Bank's projections.

The analysis emphasized the short-term volatility that had been observed in certain financial variables for some weeks, particularly interest rates and the exchange rate. About possible explanations for this behavior, it was mentioned that it was not unusual to see this kind of movements during episodes where the MPR began to be changed after a period of stability. In those circumstances, communicating the changes could be more complex. It was recalled that back in 2013 something similar had already occurred as, after an extended period of a flat interest rate, a cycle of monetary easing had followed, which lasted several quarters and was accompanied by doubts in the market about what form it would take. A second example was taken from mid-2021, at the start of an MPR hike cycle, when there was also considerable debate regarding its pertinence and the pace of the hikes. It was suggested that another reason that could explain this short-term volatility was the fact that the Central Bank of Chile was one of the first to begin reducing its reference rate, with prospects that the reduction would continue in the future. In addition, the Fed's rate hike had been quite aggressive, and doubts as to how this process would continue introduced an additional degree of sensitivity with respect to the Bank's own decisions and their effects on market financial variables. Finally, the peculiar fact of having a curve that was very inverted was noted, which could be heightening the sensitivity of the market's reactions.

3. Analysis of monetary policy options

There was agreement among the Board members that the unfolding macroeconomic scenario and the outlook for inflationary convergence allowed reaffirming the general orientation of monetary policy that had been communicated at the previous Meeting. This meant that, at the end of the year, the MPR would stand between 7.75% and 8%, and that in the medium term it would follow a downward trend consistent with achieving the inflation target. The Board reiterated that the magnitude and timing of such process would take into account the evolution of the macroeconomic scenario and its implications for the inflationary trajectory. Therefore, all the Board members considered that the plausible options for this Meeting were to lower the MPR by: (i) 50bp; (ii) 75bp; (iii) 100bp.

All five Board members agreed that the option of cutting 75bp off the MPR was fully consistent with the central scenario of the September MP Report and the general monetary policy stance that had been delivered at the previous Meeting. This option, moreover, had the advantage that it reflected most market expectations, a point to bear in mind given the high sensitivity that the MPR expectations and the exchange rate had shown to developments related to interest rate differentials.

With respect to the other options —i.e., a reduction of 50bp or 100bp—, all the Board members opined that both were consistent with the MPR corridor. In one case, whether a scenario of higher inflationary persistence or more accelerated activity was assigned more weight. In the other, if a scenario of lower inflationary pressures, caused by internal or external factors, was being considered. The Board estimated that, given the consistency of the scenario outlined in the Report and market expectations for activity, inflation and the most likely MPR trajectory, there were no compelling arguments to give greater weight to some of these scenarios. For the same reason, these options lost relevance compared to a reduction of 75bp.

4. Monetary policy decision

Governor Costa, Vice-Governor García and Board members Naudon, Céspedes and Novy voted for lowering the monetary policy interest rate by 75 basis points, to 9.5%.

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