Monetary Policy Meeting[1]

MARCH 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. Both versions are available at www.bcentral.cl

MINUTES OF THE MONETARY POLICY MEETING

Monetary policy meeting No. 272, held on 31 March 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; Solange Berstein, Financial Operations 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, Macroeconomic 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

Chilean economic conditions had worsened dramatically since the last Monetary Policy Report. The global spread of Covid-19, the measures implemented to contain it and the uncertainty about its reach had been reflected in plummeting stock markets and asset prices around the world, paving the way for a global economic recession in 2020. The Chilean economy was also being affected substantially by the pandemic, driving projections of a GDP contraction and a further deterioration of the labor market this year.

The Board had made a series of decisions to mitigate the effects of this new scenario, including a cut of 75 basis points off the MPR at a special meeting held on 16 March and the implementation of a package of extraordinary measures aimed at ensuring adequate access to credit and the normal functioning of financial markets. These measures sought to preserve the correct transmission of monetary policy and facilitate credit flow to companies and individuals in need of funds to overcome this complex stage, aiming to soften its impacts on employment, income and households' well-being.

2. Background analysis and discussion

There was discussion on the evolution of the macroeconomic outlook, concluding that despite the short time that had elapsed since the previous Meeting —on March 16— the deterioration observed was very significant. Since then, the number of confirmed cases of infection in the world had almost quadrupled, and many governments, including in countries with a limited number of cases, had applied non-pharmacological containment measures that were severely affecting productive activity. Although there were no accurate measurements, the steep drop in activity in China upon implementing the first sanitary measures anticipated double-digit monthly declines in the countries adopting them, affecting a wide spectrum of economic activities. Moreover, as the epicenter of the crisis had moved to Europe and the United States, the risk to the global economy was enormous, with a social and economic cost that could even be amplified in the emerging world.

Attention was drawn to the important need to clarify that this crisis was occurring in the corporate sector, which made it different from earlier catastrophes. In particular, a corporate crisis typically not only makes it necessary for companies to renew their loans, but it is also essential for them to be able to increase the amounts so they can cover temporary shortfalls in earnings. This posed a major challenge in a context where not many agents were willing to take risks and where the information asymmetries associated with the corporate crisis were gigantic. Therefore, in order to ensure the proper functioning of monetary policy transmission channels, the Bank might have to explore new paths never before considered. It was also stressed that acting in time to safeguard the proper functioning of the markets was key, as there was the risk of significant decapitalization of companies of all sizes, which could hurt the solvency of financial intermediaries and call for much more radical measures.

The way that local financial markets had welcomed the measures taken by the Bank was commented, in particular the MPR cut at the special meeting of 16 March. At the time —it was recalled— there was debate on whether there was a very strong trade-off between the greater monetary impulse that was necessary in the new macroeconomic scenario and the problems that could endanger the stability of the financial markets. The events of the last two weeks pointed to a significant change in this trade-off. On the one hand, the macroeconomic scenario had deteriorated significantly both internally and externally, but on the financial side there seemed to be slightly positive news. Although financial markets were highly volatile, the exceptional measures taken in many countries, including Chile, had been correctly assimilated by the markets, allowing them to gradually adjust to the new reality.

3. Analysis of monetary policy options

All five Board members agreed that the assessment of the macroeconomic outlook and its implications for inflation left no doubt that a boost in the monetary stimulus was needed. While the peso depreciation put upward pressure on inflation in the short term, this was contained by the sharp fall in oil prices, while in the medium term, inflationary pressures were clearly determined by the weakening of the economy and increasing capacity gaps.

They also agreed that the wisest decision was to bring the policy rate to its technical minimum of 0.5%. Several Board members noted that although the option to lower the MPR by 25 points was plausible, it became less valid considering the need to act quickly. In the opinion of one Board member, the only possible decision was to cut 50 basis points off the monetary policy rate.

All the Board members agreed that not only was it necessary to lower the MPR, but it was also essential to give a clear signal that this monetary policy expansionary stance would be kept for a long period of time. One Board member noted that, beginning with this Report, the MPR corridor had been added to the monetary policy communication tools. He further noted that although this corridor was created to factor in the uncertainty about the future evolution of the MPR, on this occasion he could ascertain that that it would remain at its technical minimum for several quarters.

All five Board members agreed on the need to intensify the coordination measures with the other economic authorities. One Board member recalled that while the Bank's decisions were essential for companies to cover their cash deficits and ensure their survival in such a difficult context, success in achieving this purpose required the contribution of other players, including commercial banks, regulators and the government.

4. Monetary policy decision

Governor Marcel, Vice-Governor Vial and Board members García, Naudon and Costa voted in favor of lowering the MPR by 50 basis points, to 0.5%. They all agreed that the analysis in the Monetary Policy Report was clear about the need to sustain a strong monetary impulse for a prolonged period. In particular, considering that the pandemic would cause a major drop in activity in Chile and the world during this year, followed by a rapid recovery in 2021. Its negative effects could be mitigated if credit was kept flowing to sustain the smooth functioning of the payment system, thus limiting the more persistent damages to activity, employment and income.

The entire Board agreed on the need to safeguard the proper functioning of the monetary policy pass-through channels, so the MPR reduction should be accompanied by non-traditional measures to support liquidity and boost credit. Considering the number of measures already in operation and the need to review their limits and conditions, the Board members voted unanimously in favor of extending both the amounts and maturities of the bank bond purchase program, but still keeping an eye on the prudential limits to the accumulation of these liabilities.