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, the Spanish original prevails. Both versions are available at www.bcentral.cl

MINUTES OF THE MONETARY POLICY MEETING

Monetary policy meeting No. 271 (extraordinary session), held on 16 March 2020.

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

Present the Finance Minister, Ignacio Briones.

Also present: 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, International Analysis Manager; Andrés Fernández, Economic Research 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 rapid spread of Covid-19 together with the sanitary measures adopted in various countries were beginning to severely affect the capacity of households and firms to carry out their social and economic activities normally. In recent weeks, the international financial markets were exhibiting an unusual degree of volatility and a fall of their main indicators. As a response, many central banks had anticipated their monetary policy decisions and announced a string of complementary measures intended to facilitate liquidity provision and the normal operation of their credit markets.

While Chile's economic indicators were yet to reflect the effects of these disruptions, the progression of the virus in other countries pointed at significant impacts on the affected firms' sales and cash flows. If it proved persistent in time, it could erode their solvency position, in particular that of SMEs, which would adversely affect economic activity and the labor market. Such a situation might hinder the normal transmission of monetary policy.

Taking stock of the significant changes in the macroeconomic scenario, the Board decided to conduct an extraordinary monetary policy meeting on 16 March 2020, which was communicated to the public the morning of that day.

2. Background analysis and discussion

Emphasis was placed on the uniqueness of the shock being faced. On the one hand, the effects of the social crisis that had burst out in October were still unfolding, and although the Imacec in December and January had been above expectations, other real and financial variables showed a deterioration in recent months. In particular, the behavior of salaried employment, the persistent pessimism of expectations and the meager credit growth, most notably of consumer loans, stood out. On the other hand, the global Covid-19-related sanitary crisis that had broken out in recent weeks was becoming the main factor reshaping both the global and local scenarios. Actually, our country had rapidly moved to phase 4 of the outbreak, which entailed a number of restrictions that would have immediate effects on the economy's performance. The complexity of this sanitary event was exacerbated by the difficulty of estimating its effects, because it was so unfamiliar that it was causing great uncertainty not only locally but throughout the entire world.

It was noted that an important number of central banks were adopting significant measures to mitigate the effects of the crisis. In this regard, it was recalled that the Bank had already adopted a major package of measures at the end of last year when the social crisis had significantly affected the domestic markets. Hence, if new decisions were to be made they should take into account the steps that had already been taken. It was noted that the market, in particular the exchange rate, had not overreacted to that morning's announcement of a special meeting being summoned.

It was commented that the biggest concern over the short term was the need to safeguard the proper functioning of the credit channel. This was a dominant element, both because it boosted the power of the transmission channel of monetary policy and because, in one way or another, it made it easier for the private sector to absorb some of the financial costs of the interruptions caused by the epidemic. While it seemed impossible to foresee that there would be no associated problems, this did not mean that facilities could not be devised to generate such funding and mitigate the impact on the private sector.

3. Analysis of monetary policy options

All five Board members agreed that the scenario where the country was operating was one of seldom seen, extraordinarily high, uncertainty that was sweeping through the real economy and the financial system. Undoubtedly the shock would have contractionary effects and reduce inflationary pressures in the policy horizon. There was also significant risk of contagion between real shocks and the situation of the financial system. In particular because the weaker or more vulnerable segments of the corporate sector—most specially small firms—would have a reduced capacity to sustain the dramatic adjustment in their cash flows. A particularly complex situation because the social explosion had greatly eaten into the liquidity margins of an important number of businesses and most affected sectors.

The entire Board agreed that the current situation called for a clear, multi-dimensional and mutually consistent policy response. On the one hand, it was necessary to protect and deepen the monetary stimulus, in order to address the severe contraction that the economy would suffer in the coming months, and to counteract its deflationary impact, which was being amplified by a worldwide fall in the oil price. On the other hand, it was necessary to continue ensuring the proper, flexible and stress-free functioning of financial intermediation in the main markets in which the Bank had influence, particularly fixed-income securities, plus banking and corporate financing. Finally, it was necessary to promote the flow of credit and refinancing to the private sector, which was going to be severely strained in the coming months, and where the aim was to avoid permanent damage to the balance sheets that would lead to company bankruptcies, a sharp rise in layoffs, and persistent effects on the economy and the national financial system. All the Board members agreed that this policy response should contemplate extending the current monetary stimulus and taking measures to safeguard the normal functioning of the credit markets and the effective transmission of the greater monetary impulse.

4. Monetary policy decision

All the Board members voted for adopting a set of extraordinary measures. These included opening a funding facility for the banks conditional on their increase in loans (FCIC), valid for six months, to grant credits charged to it over a term of up to four years with an initial loan amount equivalent to 3% of their commercial and consumer portfolios as reported by the Financial Market Commission (CMF) for 29 February 2020 (benchmark portfolio). It was also agreed that the additional resources channeled through the FCIF would be proportional to each entity's lending increase with respect to its benchmark portfolio, and the extension factor would be greater for loans to smaller firms (SMEs). As for its cost, it was agreed that banking firms making use of this facility would be charged an interest rate equal to the MPR in effect at the moment of request. Should the MPR be modified during the six months of the program's duration, the rate for the residual term of the credit would be adjusted to its lower value for the period.

The Board also agreed, as extraordinary measures, to include corporate bonds among the eligible collateral for all the liquidity operations in pesos in place, including the FCIC; to launch a bank bond purchase program from SOMA system participants for an amount equal to the UF equivalent of up to 4 billion US dollars; and to extend the forex sale program up to 9 January 2021.

With respect to the MPR, all the Board members voted in favor of a reduction, noting that the change in the macroeconomic scenario required a stronger monetary impulse to successfully achieve convergence of inflation to the target. Governor Marcel, Vice-Governor Vial and Board member García voted for cutting 75 basis points off the MPR, bringing it to 1%. Their argument was that the present circumstances made it necessary to act sooner, so a reduction of that magnitude would cause no major inconveniences in the domestic markets. They actually mentioned that after the extraordinary meeting had been announced that morning, the markets were betting on MPR reductions of 50 or 75 basis points, and no unexpected reaction had been observed in other variables, including the exchange rate.

Board members Naudon and Costa voted for lowering the MPR by 50 basis points, to 1.25%. In their opinion, the important financial tensions the country was experiencing—and that could increase due to the world markets' events as well as escalating domestic stress— could result in a scenario like the one Chile had endured at the end of last year, significantly affecting the functioning of the markets, including the exchange rate. Thus, they believed that the wisest thing to do was to slow down the pace of reducing the rate while boosting the rest of the measures that sought to strengthen liquidity and foster credit. According to these Board members, these measures were of first order, while they deemed correct to continue on a declining interest rate path, monitoring its effects on the evolution of the financial markets.

Several Board members (JV, RC, AN) pointed out that future movements of the monetary policy rate would be conditional not only on the evolution of the macro economy, but also on the evolution of the financial markets.