Tuesday, 31 August 2021

Monetary Policy Meeting – August 2021

At its Monetary Policy Meeting, the Board of the Central Bank of Chile decided to raise the monetary policy interest rate by 75 basis points, to 1.5%. The decision was adopted by the unanimous vote of its members.

The external scenario continues to anticipate a sustained recovery of the world economy, in a context where various countries are seeing a steady opening of their economies. Still, short-term indicators reveal a moderation in activity in the main economies, where there is some concern about the spread of the delta variant of Covid-19. In the emerging economies, the slow pace of vaccinations paints a less auspicious picture. Even so, because of inflationary pressures, several central banks have been joining others in the normalization of the monetary stimulus. With ups and downs, the copper price has remained at around US$4.2 per pound, while oil prices continue to be high. International financial markets maintain a positive tone, beyond movements associated with the pandemic's evolution or changes in expectations for U.S. monetary policy, with new drops in long-term interest rates and stock market increases in developed economies.

In Chile, the performance of financial markets continues to be largely dominated by idiosyncratic factors, most notably the possibility of new massive withdrawals of pension savings. Interest rates in the fixed-income market have posted additional increases since the last Meeting, especially in the short end of the nominal curve. Ten-year rates also rose, widening the distance from their external peers. This contrasts with the significant drop in shorter-term UF yields, linked to the increase in inflation expectations, especially after the surprise in the July CPI figure. The exchange rate sustained its upward trend, with the peso accumulating a depreciation of close to 5% against the dollar since the last Meeting. The selected stock index IPSA showed some rebound in recent weeks, but it persists below its figures of earlier in the year. On the banking credit side, activity retains, in general, limited dynamism, amid the greater liquidity in the hands of households and businesses. Worth noting is the fact that the increase in long-term interest rates has already begun passing through to the mortgage market.

In terms of activity, second-quarter GDP recorded an annual variation of 18.1%, exceeding the forecast in the June Report. The composition of spending showed extraordinary dynamism of private consumption, which surpassed expectations and indicates that liquidity injections to households are having a greater effect on consumption than expected. Data from the beginning of the third quarter confirm this trend, with retail sales remaining very strong. The extension of transfers to households until the end of the year means that the growth in fiscal spending forecast for 2021 will be higher than considered in the last Report. Investment has also surprised on the upside, heavily concentrated in its imported machinery and equipment component. The labor market continues to be affected by opposing forces, although with recent improvements. On the one hand, the May-July quarter saw an increase in employment in the main occupational categories (INE), while vacancy indicators are still on the rise, in line with the greater openness that has been taking place since the end of the second quarter. On the other hand, a reduced labor supply and gaps continue to be observed in the evolution of self-employment, some economic sectors, and women. The evolution of wages is consistent with growing labor shortages.

Annual CPI inflation increased again in July (4.5% annually; 0.8% monthly). Core inflation rose to 3.8% annually, driven by higher prices of both goods and services. Short-term inflation expectations have risen most recently. In the two-year term, the median of the Economic Expectations Survey (EES) is at 3%, while the Financial Traders' Survey (FTS) showed an increase to 3.5%.

Higher activity growth and the strong expansion of consumption virtually closed the activity gap in the second quarter, and will turn it positive soon, increasing the pressure on prices. This has resulted in higher inflation and raises its short-term outlook. This result is compounded by the unfavorable behavior of other inflation-relevant variables, such as the greater exchange rate pass-through of the idiosyncratic peso depreciation, global supply that has yet to make a full comeback after the pandemic, and the increase in fuel prices.

The Board has responded to the need to avoid the accumulation of macroeconomic imbalances that, among other consequences, could trigger a more persistent increase in inflation that would deviate it from the 3% target in a two-year horizon. Consequently, the Board decided to intensify the withdrawal of monetary stimulus, by raising the MPR by 75bp at this Meeting. The Monetary Policy Report to be published tomorrow contains the details of the central scenario, the sensitivities and risks around it, and its implications for the future evolution of the monetary policy interest rate.

The minutes corresponding to this Monetary Policy Meeting will be published at 8:30 hours of Wednesday 15 September 2021. The next Monetary Policy Meeting will take place on Tuesday, 12 October and Wednesday 13 October 2021, and the statement thereof will be released at 18:00 hours of the second day.

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* The Spanish original prevails.