Wednesday, 12 May 2023

Financial Policy Meeting – first half 2023

At its Financial Policy Meeting, the Board of the Central Bank of Chile decided to activate the Counter-cyclical Capital Buffer setting it at 0.5% of risk-weighted assets, due in one year. The decision was adopted by the unanimous vote of the Board members.

The Financial Policy Meeting is the instance at which the Board of the Central Bank of Chile decides on the Counter-cyclical Capital Buffer (CCyB). This tool is framed within the Basel III capital standards for the banking system, in accordance with the provisions of Article 66 ter of the General Banking Law. The CCyB is a macro-prudential requirement whose purpose is to enhance the economy's resilience when faced with severe stress scenarios originating in risks of systemic nature.

Regarding the context where this decision is made, in the external scenario, it is worth noting the deterioration of financial conditions since late last year, which has increased uncertainty about its future evolution. The banking stress episodes brought to light shortcomings in the regulation, supervision and risk management of the affected entities. Although the reaction of policymakers has contained said turbulences, doubts persist in the market with respect to the financial systems in developed economies. As for credit, both the Eurozone and the United States have seen tighter lending standards and a weaker demand. All this is taking place in a scenario where the sharp rise of inflation put an end to a long period of low interest rates and high liquidity. The risks still present for the convergence of inflation maintain the concerns about how long the contractionary tone of monetary policy will last in the main economies.

At home, macroeconomic imbalances continue to adjust. Private consumption continues to dwindle, fiscal indebtedness has stabilized, and the current-account deficit has moderated further. In both the fixed-income and forex markets, risk premiums have decreased. The analysis of various financial indicators does not reveal vulnerabilities amplifying systemic risks. Attention remains focused on retail, construction and real-estate firms. Among households, the risk is still concentrated in the lower income groups, who have increased their financial burdens via increased use of credit cards and lines. Credit default has risen for both households and firms and is near pre-pandemic levels.

Lending activity does not show misalignments with the economy's growth, in a context in which the first-quarter Bank Lending Survey shows lower demand and more supply-side constraints, the latter because of a higher risk perception.

The stress tests of the banking system, that will be presented in the Financial Stability Report, attest to the solvency of our banking system. Its level of provisions and capital is sufficient to face a severe-stress scenario. Notwithstanding, the system is in the process of converging to Basel III.

The Board has activated the CCyB as a precautionary measure considering the higher external uncertainty environment. Although the macroeconomic scenario has evolved in line with expectations, there has been an increase in the risk of a severe external shock occurring. Although unlikely, its negative effect on the economy would be significant. In such case, liberating the previously constituted CCyB will help mitigate the impacts with respect to the evolution of credit to households and businesses.

The Board estimates that, considering the current level of capitalization, the banks' buffers, the level of CCyB and the term defined to complete it, its activation will have limited and temporary effects on the evolution of credit. Moreover, the implementation of the CCyB is part of a context where all the economic players need to continue to restore their capacities to deal with possible adverse events.

The defined level and term of the CCyB has the favorable previous report of the Commission for the Financial Market.

The minutes of this Financial Policy Meeting will be published at 8:30 hours of next Wednesday 7 June. The next Financial Policy Meeting will take place on 6–7 November 2023 and the Statement thereof will be released at 18:00 hours of the second day.

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*The Spanish original prevails.

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