# Monetary Policy and the Labor Market: The Chilean experience[1]

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Good afternoon, I would like to begin by thanking the Governor of the Central Bank of Portugal, Mario Centeno, for being able to present with such distinguished participants. Unfortunately, due to scheduling constraints, it has not been possible for me to join them in person on this occasion.

Chile's labor market presents some characteristics that are common to those of other emerging economies. Female labor force participation is slightly lower than in developed economies (52.1% in Chile vs 53.8% OECD average, and 57% in the US).[2] Informality levels are around 26.4%,[3] a figure in line with other emerging economies but far higher than for developed ones. In turn, the labor force participation of older workers is relatively high: for those aged 65 and up, the participation rate is 19.6%, while the average of the OECD is 15.9%. This goes hand in hand with relatively low pension earnings for retirees.

There are, however, some characteristics that are distinctive of the Chilean economy: labor mobility is very high, much more so than in other economies (both developed and emerging) (Figure 1).[4] This labor mobility does not, however, come hand in hand with wage growth: while most job transitions are associated with wage increases (54% of cases), a significant portion of turnover does not bring higher income (46%). Similarly, job movements are not necessarily towards more productive companies. These features confer the Chilean labor market multiple adjustment margins, such as informality, self-employment, labor mobility and wage adjustment, to respond to cyclical disturbances, thus reducing the impact on unemployment.[5]

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[1] Presentation of Governor Rosanna Costa at Banco de Portugal: Conference Monetary Policy Transmission and the Labour Market, March 7, 2025

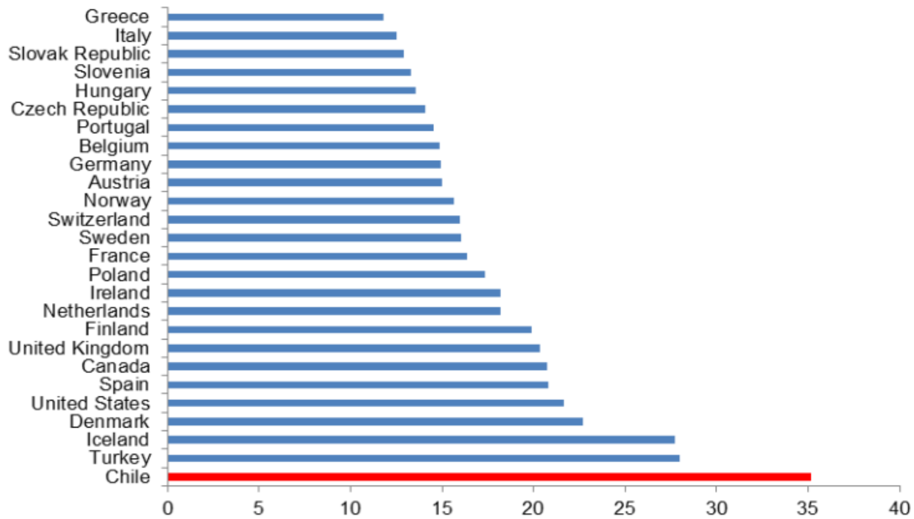
[2] Ocupación y desocupación (INE); Labour force participation rate (OECD)

[3] Informalidad y condiciones laborales (INE)

[4] Albagli et al. (2017) [DTBC No. 812]

[5] Mercado Laboral: hechos estilizados e implicancias macroeconómicas – Banco Central de Chile – 2018.

**Figure 1**
Job reallocation, cross-country comparison
(percent)

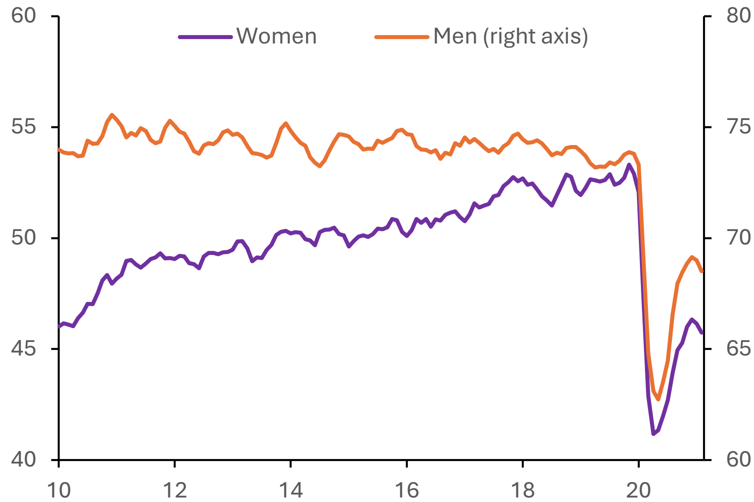



Source: Albagli et al. (2017).

The Covid-19 pandemic hit the world economy hard, and Chile was no exception. The nature of the shock was exceptional, and the labor market was especially hard hit due mainly to sanitary restrictions and lockdowns that were long-lasting and widespread in Chile. By July 2020, unemployment had risen to 13,1% (from around 7% the year before) and layoffs had increased 38% in March 2020. Participation rates also decreased substantially, as some workers, especially women, had to exit the labor market to care for children and/or elderly family members (Figure 2). There was a decrease of 10.9 percentage points for women and 10.6 percentage points for men.[6] Older workers who faced higher risks from Covid, and young workers who could start higher education programs online also exited the labor market in high numbers.

[6] Box III.1 IPoM June 2020

**Figure 2**
Labor force participation rates (2010 – 2021)
(percent)

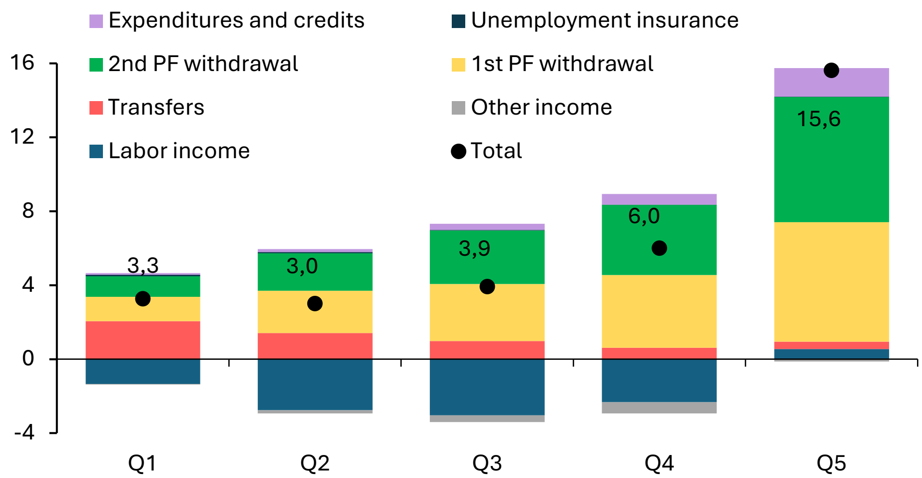



Source: National Statistics Institute (INE).

Monetary policy was brought to the effective lower bound in April 2020, and several other policies were implemented during those first months to support firms and workers, such as liquidity provision to commercial banks, credit guarantees for firms, and labor protection programs by which firms could retain workers that were not attending work. Later in 2020 other measures were implemented, such as pension fund withdrawals and fiscal transfers to more than 80% of individuals.[7] Overall, total stimulative measures accounted for more than 30% of GDP, and income increased for all income quintiles despite a drop in labor income for the lowest quintiles (Figure 3).

[7] Ministerio de Desarrollo Social y Familia

**Figure 3**
Change in income and additional liquidity, 2020
(billions of dollars)



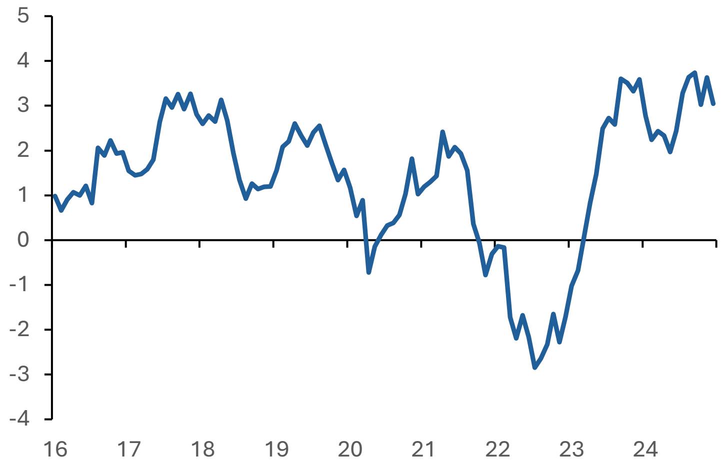

Source: Barrero et al. (2020).

As activity gradually normalized and restrictions on mobility eased, production resumed in most sectors. Those that took longer to return to normalcy were some services sectors, such as restaurants and hotels, which were more exposed to sanitary risks related to Covid. Despite stimulus measures such as subsidies for firms that hired new workers, implemented in September 2020, labor force participation did normalize, but at a slow pace. Some groups of workers took longer to come back to the labor force, as schools took a long time to operate normally and cumulative earnings from the previous months allowed many to remain out of the labor force for longer periods. This behavior of the labor market was not an outlier: a study carried out at the Bank showed that countries where fiscal aid was more generous, while they were able to protect the most vulnerable households, may have seen a delay in the recovery of the labor force.[8]

While in developed economies labor markets showed evident signs of being highly constrained and wage increases exerted additional pressure on costs and prices, the situation was different in Chile. By December 2022, the Chilean labor market showed limited dynamism and low indexation, which reduced the risks for inflation convergence[9] (Figure 4).

[8] Box I.3 in September 2022 IPoM.
[9] Box I.2 in December 2022 IPoM.

**Figure 4**
Annual growth in real wages
(percent)




Source: National Statistics Institute (INE).

Inflation went down from its peak of 14% to around 3% in early 2024. This dramatic fall was the result of a large drop in demand due to restrictive monetary policy, along with the withdrawal of fiscal stimulus packages during 2022, and the normalization of domestic production and international trade. As economic activity slowed down and the Chilean economy resolved its imbalances of previous years, unemployment increased, albeit at a lower rate than what would have been expected ex-ante and reached 9% in late 2023/beginning of 2024. Labor force participation has picked up since the pandemic, but some groups have taken longer than we had expected to return to pre-pandemic levels and some may never return at all. This is the case, most notably, of workers that were 55 years old or older when the pandemic broke out.[10]

During 2024, the Chilean economy was subject to additional shocks. Electricity prices were adjusted after years of being frozen, at the expense of acquiring debt with private firms. This translated into 1pp higher inflation for the year. Beyond an appreciation over the past month, the currency depreciation since mid-2024 has reaccelerated goods inflation. In addition, a number of laws related to the labor market were passed and/or started being implemented and they have exerted additional pressure on the cost structure of firms. In December 2024, we published an analysis carried out at the Bank that shows that recent increases in the minimum wage of nearly 15% in real terms led to a 4.3% rise in average wages for firms with a higher proportion of minimum wage workers, relative to firms with a lower fraction of minimum wage workers, with a cumulative differential effect of 7.8% 16

[10] Box I.3 in March 2024 IPoM.

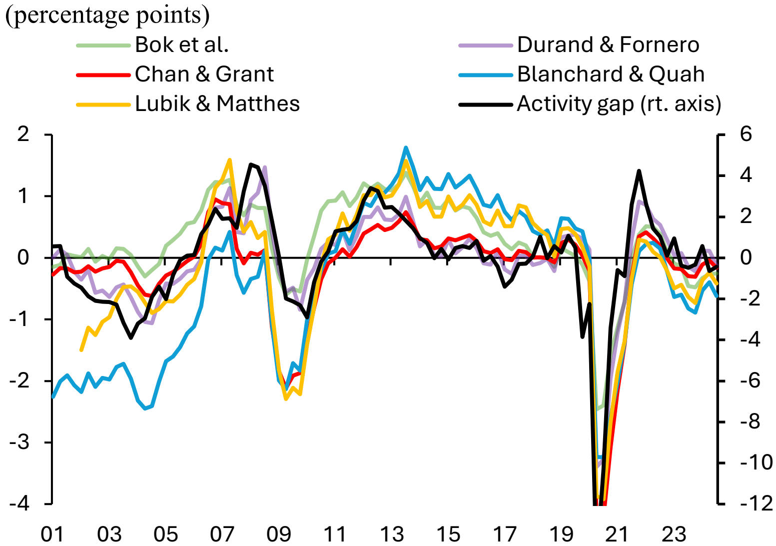
months after the introduction of the policy.[11] Besides, the minimum wage increase had a negative impact on the level of employment of firms with more workers subject to it. Other labor market regulations have taken place at the same time, such as a reduction in working hours (from 45 hours/week to 40 hours/week to be gradually implemented by 2028), anti-harassment legislation and, more recently, a pension system reform that increases pension contributions and establishes that these should be paid by employers. At the same time, real wages have increased in the last year at a faster pace than before the pandemic (12-month average percent change in 2024 was 2.88%, compared with 1.98% in 2018-2019).[12]

Meanwhile, labor demand is weak, although it is showing some signs of recovery in the last few months, and unemployment remains high, at around 8%. However, unemployment gap measures, which are computed as the difference between unemployment and a reference rate such as the NAIRU, are close to zero[13] (Figure 5). This is in line with measures of the output gap and with the fact that the Chilean economy is growing at a rate that is very close to trend.[14]

**Figure 5**

Unemployment and activity gaps

(percentage points)




Sources: Levenier et al. (2024) based on National Statistics Institute (INE) and Central Bank of Chile.

To conclude, let me summarize the current outlook for labor markets and monetary policy. After the pandemic, labor markets normalized but at a slower pace than in other countries, and participation

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[11] Minutes cited in December 2024 IPoM.

[12] Employment & Wages and Demographics (BDE).

[13] Box II.1 in December 2024 IPoM.

[14] Box II.1 in September 2024 IPoM.

rates of some groups have not yet returned to their pre-pandemic levels. Although inflation reached double digits, labor markets were never as tight as in other developed and emerging economies with similar inflation spikes, and inflationary pressures were not particularly exacerbated by wage increases. We raised the monetary policy rate substantially to control excess demand and tame inflation, which resulted in a decrease in labor demand and a surge in unemployment. We are currently facing higher (than average) levels of unemployment, weak labor demand, and high labor costs mostly due to novel labor market regulations that put upward pressure on future production costs and, ultimately, inflation.

The developments in the labor market are probably a reflection of the characteristics of the Chilean labor market that I described at the beginning of my talk: the combination of unusually high labor mobility, high informality, and low wage growth may translate into relatively milder cyclical fluctuations of unemployment and, consequently, lower-than-expected inflationary pressures exerted by wage increases. This is not to say, however, that wages and employment fluctuations are not relevant for economic activity and inflation. They indeed are, as we are currently seeing, but they tend to respond more to longer-lived shocks and structural changes and less to short-lived shocks compared to other economies.

Let me finish by saying that the relationship between monetary policy and the labor market is bidirectional: monetary policy plays a role in the short-term fluctuations of the labor market, and at the same time, labor markets play a role in economic activity and inflation fluctuations, thus impacting monetary policy decisions. These connections are complex and ever- evolving, and although we have acquired substantial knowledge over the years about the labor market, we keep close tabs on its developments, and we are always learning new lessons and adapting our frameworks to better capture the changing environment.

Thank you.