NATIONAL ASSET LIABILITY MANAGEMENT AMERICAS VIRTUAL CONFERENCE, 14th September – 18th September, 2020

Panel discussion: How has this year changed central banks strategic and tactical asset allocation?

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My main focus will be on the changes in Central Bank Balance in the last year, with some comments on some of the challenges ahead.

This has been a very eventful year for Chile, and the Central Bank in particular. Since September last year we had to deal with three major shocks with large impact in our balance sheet:

October – November 2019: ***Large social unrest*** accompanied by widespread violence and looting, with a breakdown in public order and security. After a month and a half of turmoil, a political agreement to start a process leading to a new Constitution restore order. This process will take 2 years, and the first step is a Referendum to approve or reject this process and to choose the type of political body that will produce the proposal. This will take place at the end of October.

This was a domestic shock, causing a lot of uncertainty, leading to massive portfolio shifts, mostly from domestic assets to foreign assets. It caused large short-term liquidity problems in the FX market as well as in the short-term domestic market.

The Central Bank intervened in the FX market announcing a large program to sell USD in the spot market, as well as in the NDF market. In parallel we launched a program to buy back the remainder of our own long-term domestic debt, as well as a more traditional REPO Program.

These measures calmed the markets, with just a fraction of the resources committed being used.

March 2020: ***COVID financial turmoil*** in global markets impacted Chile, followed by domestic lockdowns causing a massive (but partial) shut down of economic activity, particularly in services.

This was a global shock causing a shift in asset allocation favoring short-term liquidity, both in peso and USD.

The main concern at the Bank with respect to the pandemic, in addition to the smoothing of the portfolio shift, was to prevent a sudden stop in domestic credit by banks, so in coordination with actions by the government, we provided liquidity to banks to promote actual increases in commercial credit. The idea was to help bridge the financial gap caused by the temporary interruption of economic activities.

- Provision of Domestic Liquidity: Program of purchases of Bank Debt, in addition to our own.
- Extension of FX liquidity through NDF (very limited in fact)
- New Credit facility to banks: 4 year loans at a fixed interest rate (0.5%, the MPR), conditional to previous increases in commercial loans (USD 20 b. in the first stage, a second stage is now being implemented)

August 2020: ***Withdrawal of 10% of Pension Funds savings (capped)*****.** Large domestic liquidity shock (6% of GDP to be withdrawn in two installments, by more than 6 million affiliates in a week time each). Domestic liquidity squeeze for AFPs and money market institutions, with an impact on asset prices and the FX market. Severe operational stress both for AFPs and the Banking System.

- New program to buy Bank Bonds (at a discount)
- Purchase of Bank deposits
- Quasi repo open to all financial market institutions, using Bank Bonds (temporary purchase of bonds) aimed to provide short –term liquidity.

Only a fraction was used, partially because AFPs anticipated part of the adjustment. After the CB announcement markets calmed and the transfer of funds went smoothly.

Overall impacts on the Central Bank Balance:

- Large increase in size
- Domestic Assets (and short- term debt) play now a major part in our Balance
- Got us closer to a positive Net Assets Position
- In March we moved to a new benchmark for International Reserves, shortening duration

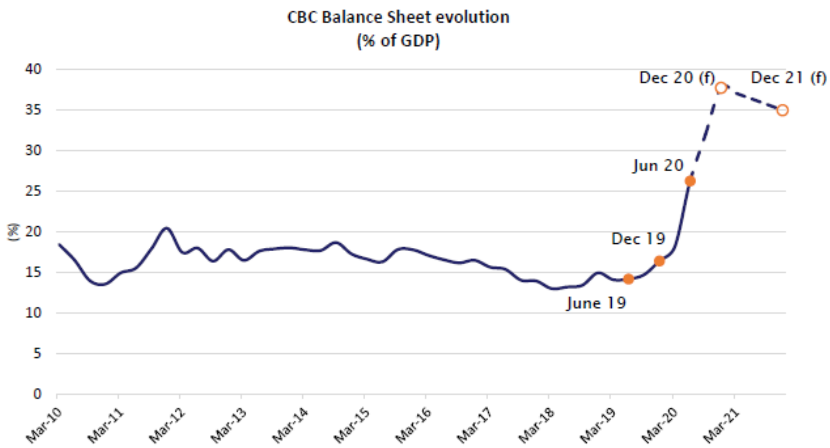
The recession and fiscal transfers program to deal with its consequences also brought major changes in the Fiscal Position. Large deficits expected now in 2020 (10% of GDP) and 2021, followed by Fiscal consolidation afterwards, with gross Public Debt expected to stabilize close to 50% of GDP in 2024. Part of the funding has come from withdrawals in Sovereign Funds.

One last word about International Reserves: they have not changed that much: from USD 38.9 b. a year ago to USD 37.7 b. at the end of August.
In the meantime we have gained access to special liquidity facilities:
FCL (IMF): USD 23.9 B. (two years)
Repo FIMA (Fed): Up to USD 60 b. (USD 17.5 b. now)
PBOC Swap line: USD 7.1 b. (equivalent).

Some challenges ahead:

1. Revision of the size and composition of International Reserves will take place in the next couple of years.
2. The winding down of the FCIC and different asset purchases, as the economy recovers.
3. Operational challenges to be able to manage a very different set of assets in our Balance.
4. Criteria and indicators to use the new ability to purchase Treasury Bonds in the secondary market, to deal with financial stability problems.

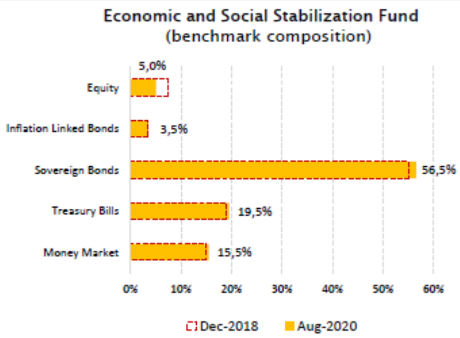
Central Bank of Chile: Balance Sheet evolution

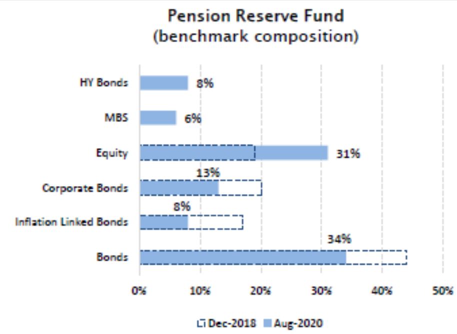


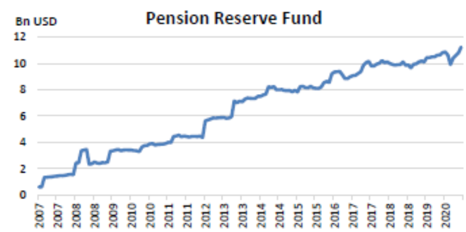
Evolution and composition of Assets and Liabilities

Balance sheet, Central Bank of Chile (% GDP)		
	mid 2019	end 2020 (f)
Assets	***14,4%***	***37,8%***
International Reserves	14,0%	15,5%
Domestic Credit (FCIC)	0,0%	16,9%
Bank bonds	0,0%	4,3%
Repos	0,1%	0,7%
Other assets	0,3%	0,4%
Liabilities	***16,3%***	***37,7%***
Monetary Base	6,5%	10,5%
Long Term debt	3,5%	0,0%
Short Term debt	4,4%	18,8%
O/N deposits	0,7%	5,9%
Other liabilities	1,2%	2,5%
Net Worth	***-1,9%***	***0,1%***

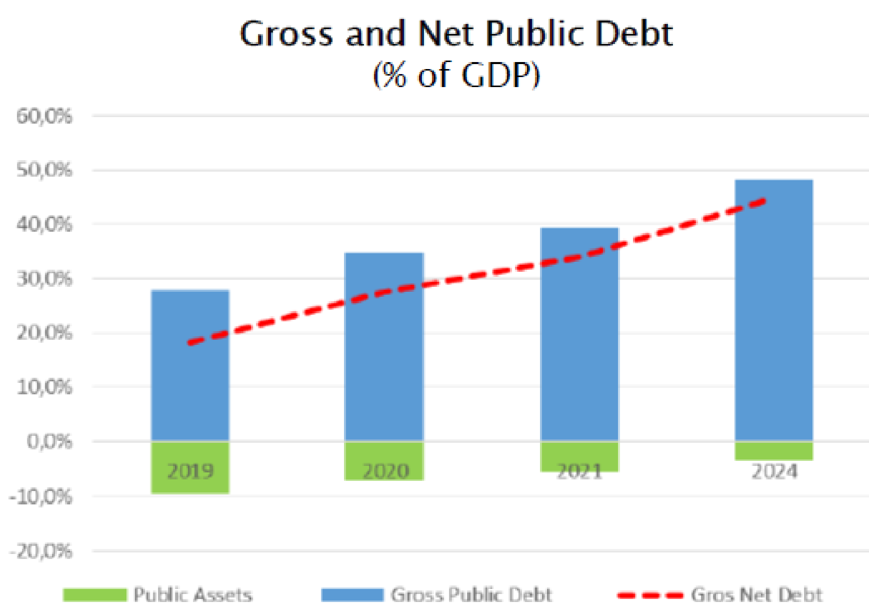
Sovereign Wealth Funds







Expected evolution of the Financial position of the Government



Source: Budget Office