

# Social Unrest and Economic Performance in Chile



Joaquín Vial  
*Deputy Governor*  
*Central Bank of Chile*

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# Agenda

1. Social unrest in Chile and its economic impact
2. The short-term policy responses
3. Economic prospects
4. Concluding remarks

A globe is centered in the background, resting on a grid pattern. The entire scene is overlaid with a semi-transparent blue layer. The globe shows the Americas and parts of Europe and Africa. The grid lines are light blue and intersect to form a diamond pattern.

# 1 Social unrest in Chile and its economic impact

## *Social unrest in Chile and its economic impact*

Social unrest has different actors and different ways of expression, all relevant but with different economic effects

### Three faces of social unrest

Social unrest in the country has shown three faces, each with its own effects on the economy, but the end result is an increase of uncertainty:

- *Mass demonstrations*
- *Violent episodes*
- *Politics*

## Social unrest in Chile and its economic impact

# Direct costs of damages to public and private infrastructure

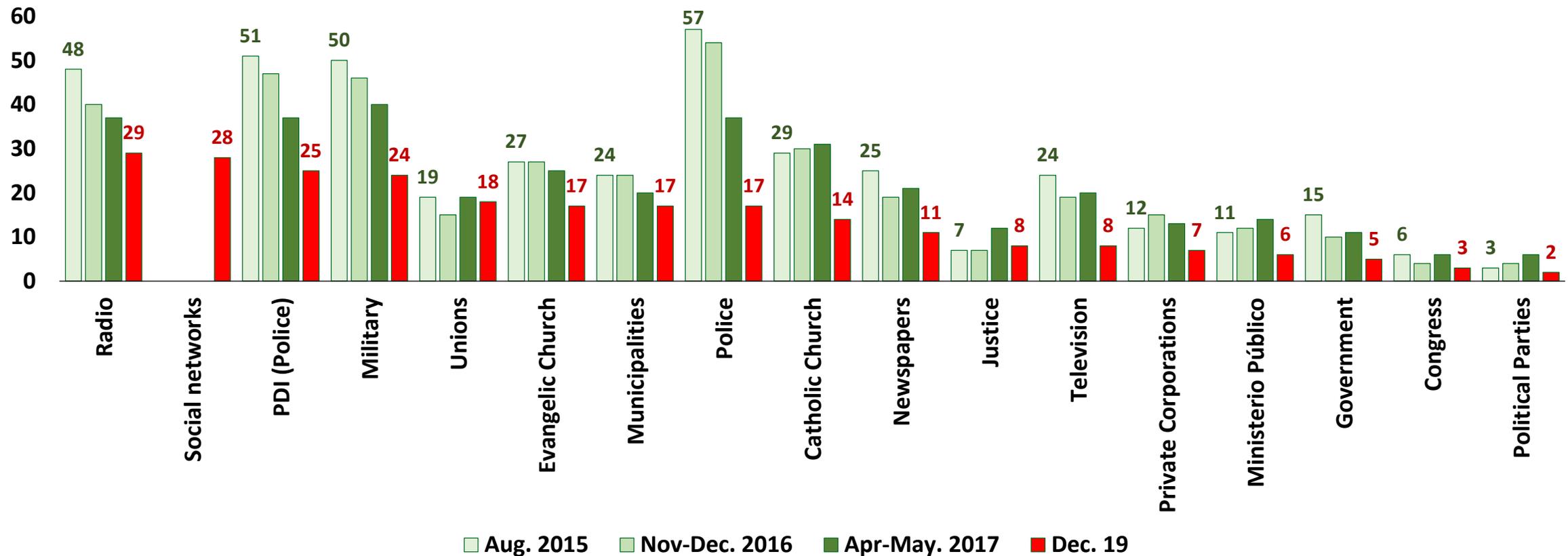
### Damage to public and private property

Damages to	Quantity	Accumulated until	Source
Public and private assets excluding Subway	US\$ 3000 mm	Nov 03, 2019	<i>Ministry of Economy</i>
Subway	US\$ 300 mm	Oct 23, 2019	<i>Metro SA</i>
Public and private assets in Santiago	US\$ 900 mm	Oct 25, 2019	<i>Cámara de Comercio de Santiago</i>
Estimation of lost sales in Santiago	US\$ 500 mm	Oct 25, 2019	<i>Cámara de Comercio de Santiago</i>
Retail stores affected by looting, destruction or fires in Santiago	677	Oct 23, 2019	<i>Cámara de Comercio de Santiago</i>

# Social unrest in Chile and its economic impact

## Direct political damages are huge

Confidence rates in different Chilean institutions (\*)



(\*) % of the sample that express confidence in each institution. Source: CEP Survey, December 2019.

## *Social unrest in Chile and its economic impact*

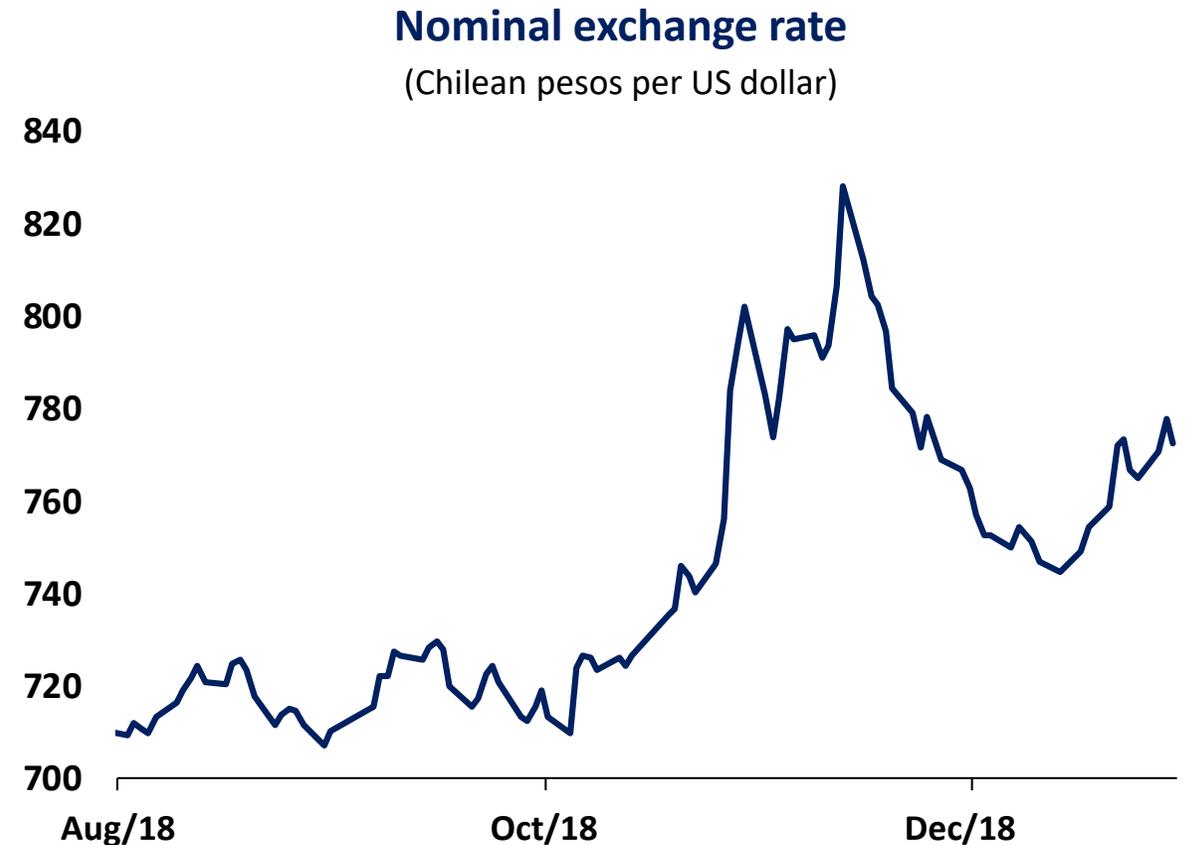
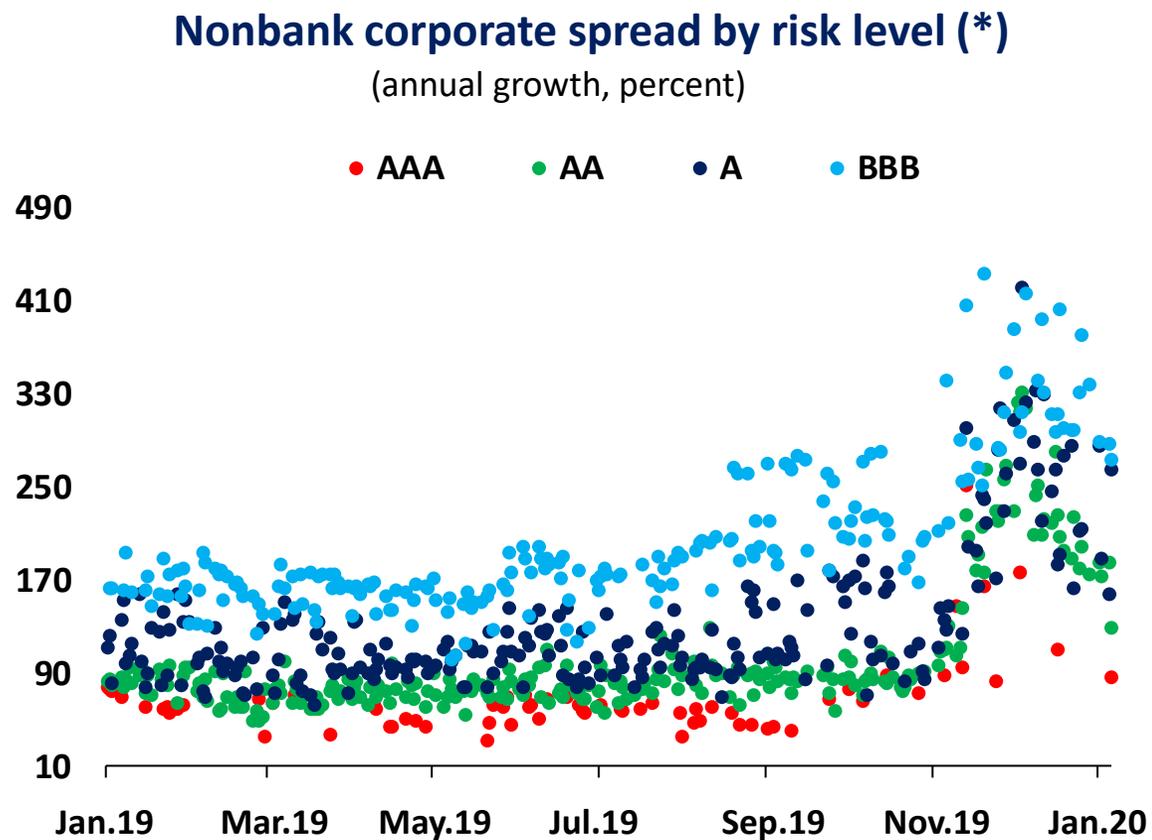
The financial system is the first to reflect the reactions to these events. There are several transmission channels to the financial system

**International experience suggests five channels through which these types of situations can be transmitted to the financial system:**

- i. *Volatility of key prices.*** Different agents, such as businesses and households, could be exposed to abrupt changes in the exchange rate or interest rates
- ii. *Activity and employment.*** Falls in activity and employment generate difficulties for the payment of commitments of the different agents, increasing delinquency
- iii. *Vulnerable sectors and disruption of payments or credits.*** Among the different economic agents, there are groups that are more vulnerable economically, for which the impact of an adverse scenario may be greater and could even affect other sectors
- iv. *Destruction of physical capital, collateral quality and guarantees.*** Disruptions not only impacts the cost of replenishing capital and productive capacity, but also the quality of collaterals used to access financing
- v. *Change in risk perception, preference for liquidity, credit supply and other financial services.*** Agents opt for greater savings for precautionary reasons while increasing their preference for liquidity, reducing the funds available for project financing

## Social unrest in Chile and its economic impact

The financial markets did not react after the initial (large) demonstrations, but were shaken when protests turned violent and widespread

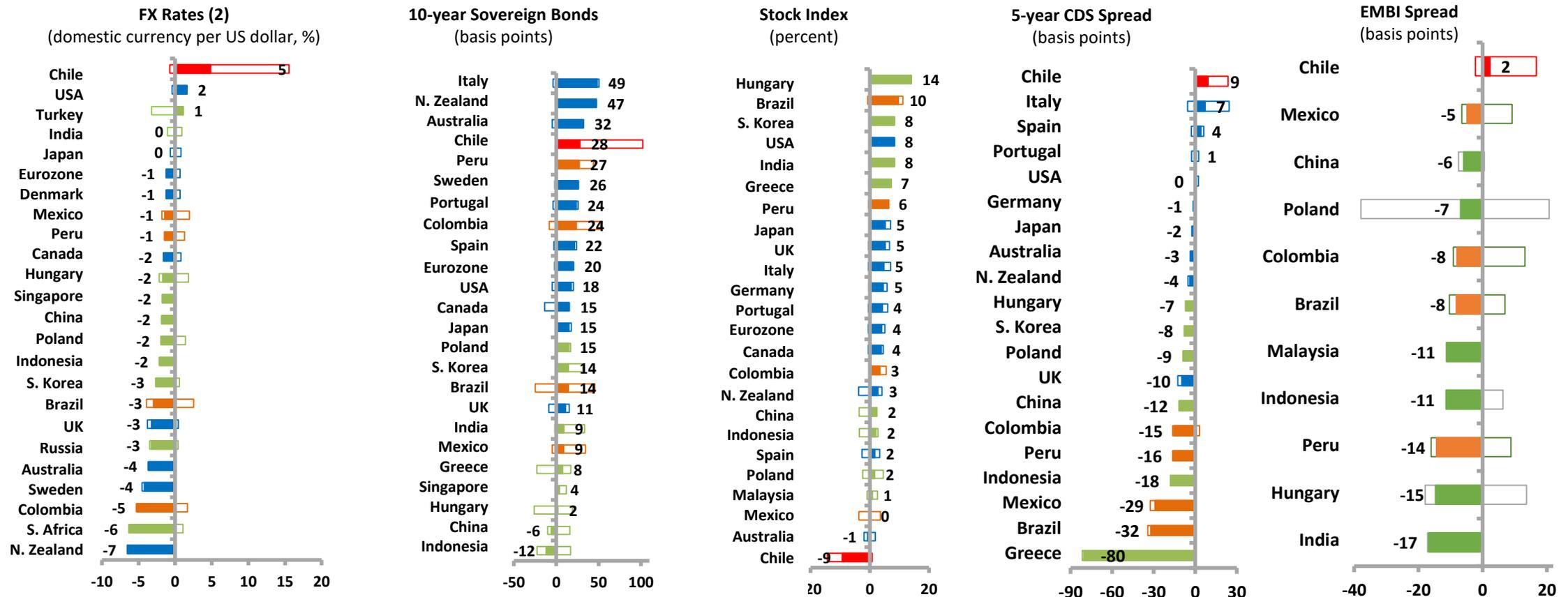


(\*) The spread over the UF sovereign bond rate. Each dot is the daily average weighted by the amount of each instrument in the category. The last datum is preliminary. Source: Central Bank of Chile.

# Social unrest in Chile and its economic impact

## Several financial market indicators show a deterioration and a (limited) increase in risk perceptions

### Financial markets: changes between October 16, and December 31, 2019 (1)



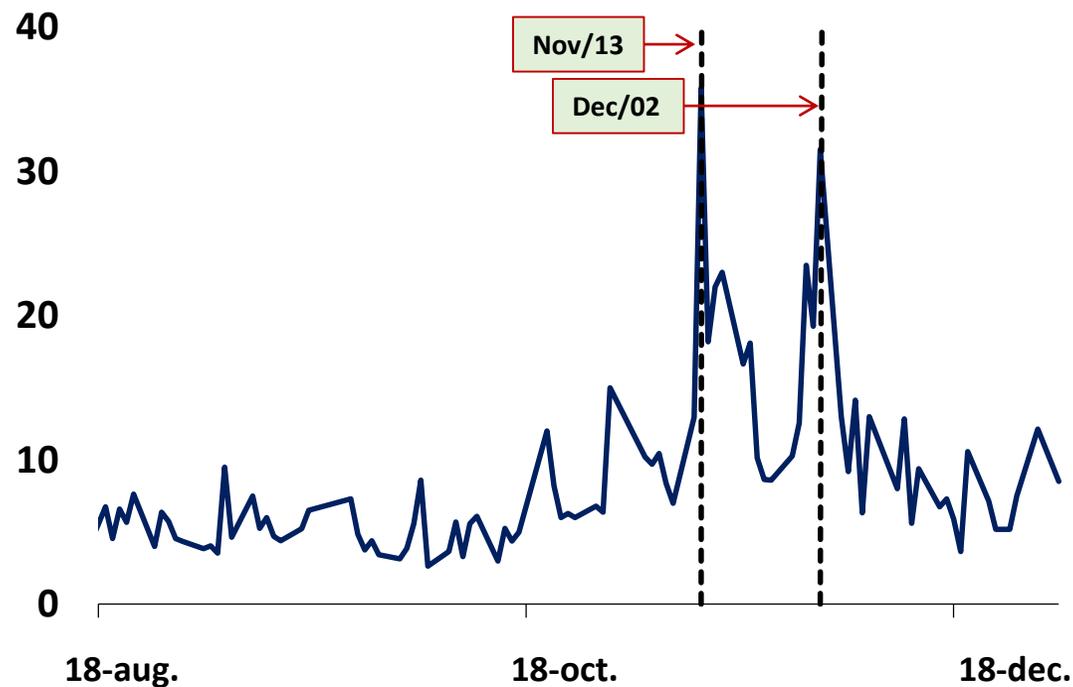
(1) Green bars shown EMEs, oranges shown LATAM, and blue shown AEs. Filled bars indicate variation between Oct/18 until Dec/26, 2019 and transparent bars indicate maximum and minimum changes. (2) An increase indicates depreciation. Source: Central Bank of Chile and Bloomberg.

## Social unrest in Chile and its economic impact

There were signs of significant short-term liquidity stress due to reallocation of portfolios

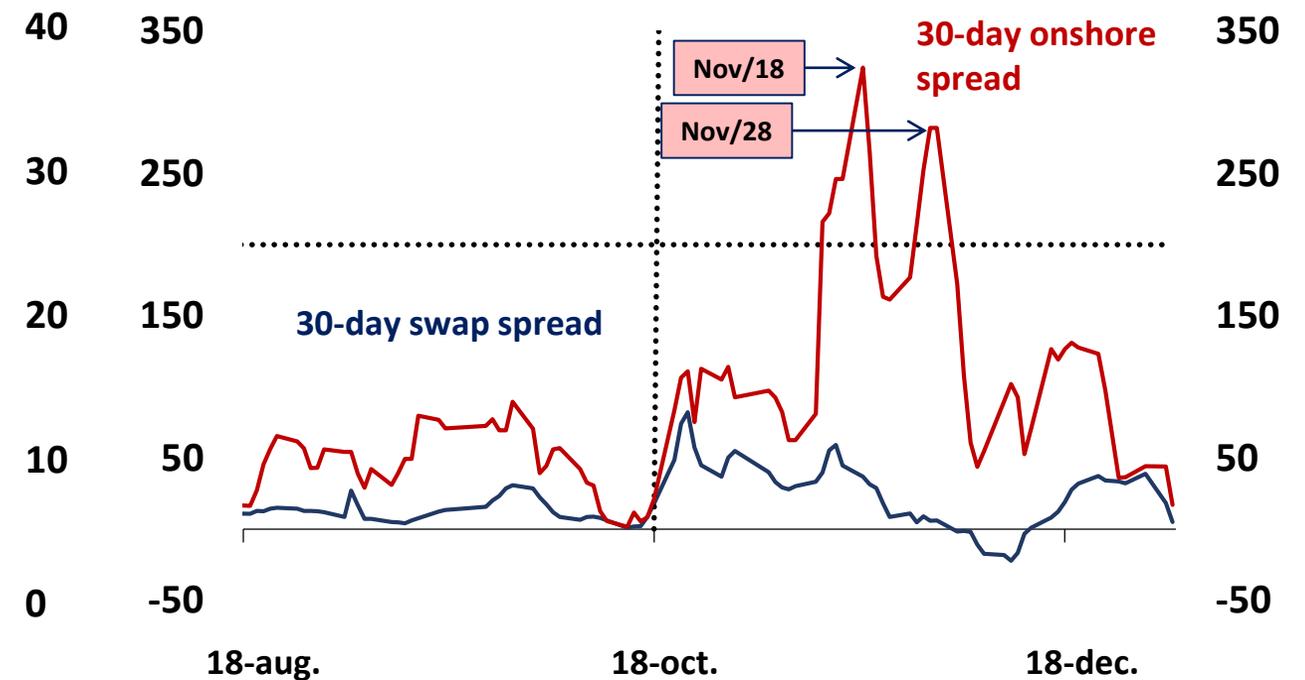
### Daily volatility of the NER (1)(2)

(Chilean pesos)



### Onshore spread and time deposit-swap spread (3)(4)

(basis points)



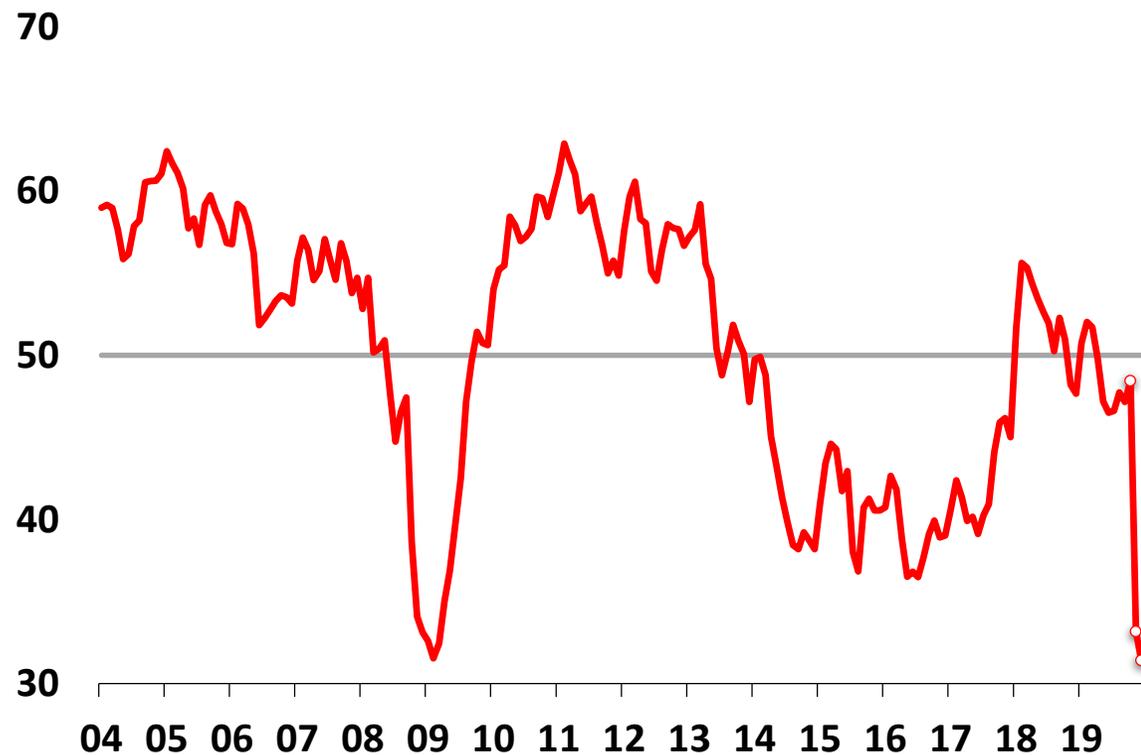
(1) Calculated as the difference between the maximum and minimum daily rate. (2) Left vertical dotted line marks the start of the social crisis; central vertical dotted lines = the first announcement of liquidity measures taken by the CBC (November 13); right vertical dotted line = starting point of foreign exchange intervention by the CBC (December 02). Source: Bloomberg. (3) Horizontal dotted line indicates the minimum swap auction rate. (4) Vertical dotted line marks the start of the social unrest. Source: Central Bank of Chile.

## Social unrest in Chile and its economic impact

# Surveys show an unprecedented drop in business and consumers confidence

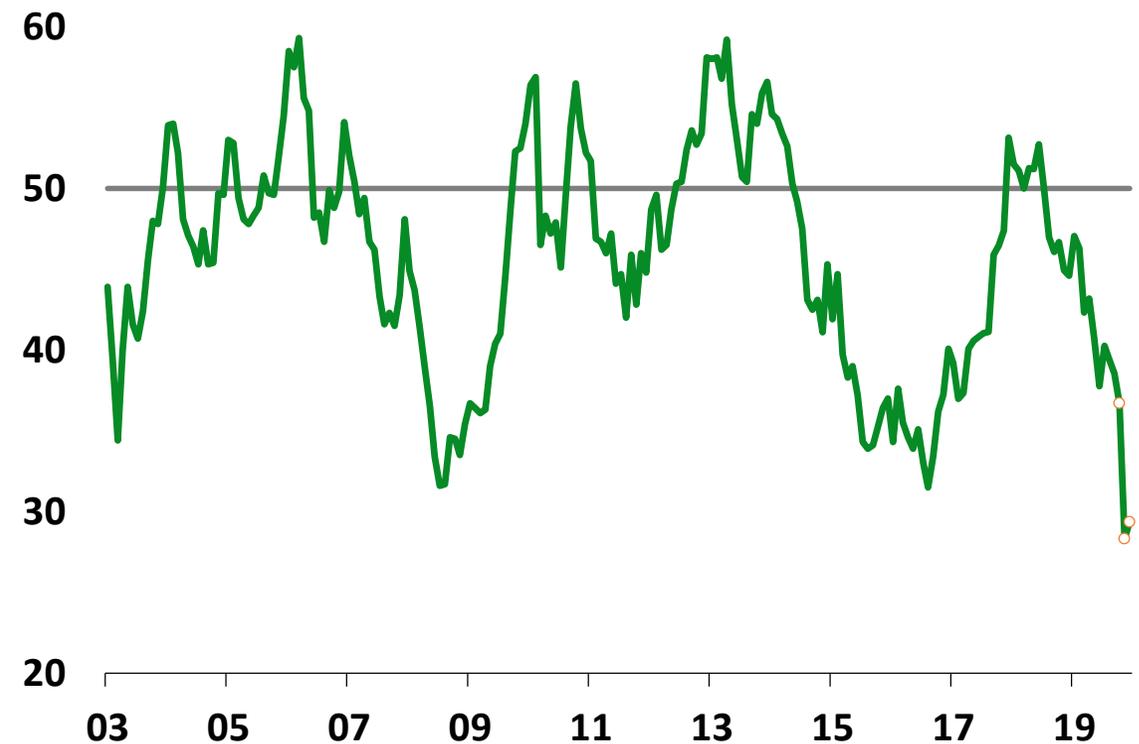
### IMCE: Entrepreneurs expectations (1)

(index)



### IPEC: Consumers expectations (2)

(index)



(1) Value over (low) 50 points indicates optimism (pessimism). Source: ICARE/Universidad Adolfo Ibáñez. (2) Value over (low) 50 points indicates optimism (pessimism). Source: GfK Adimark.

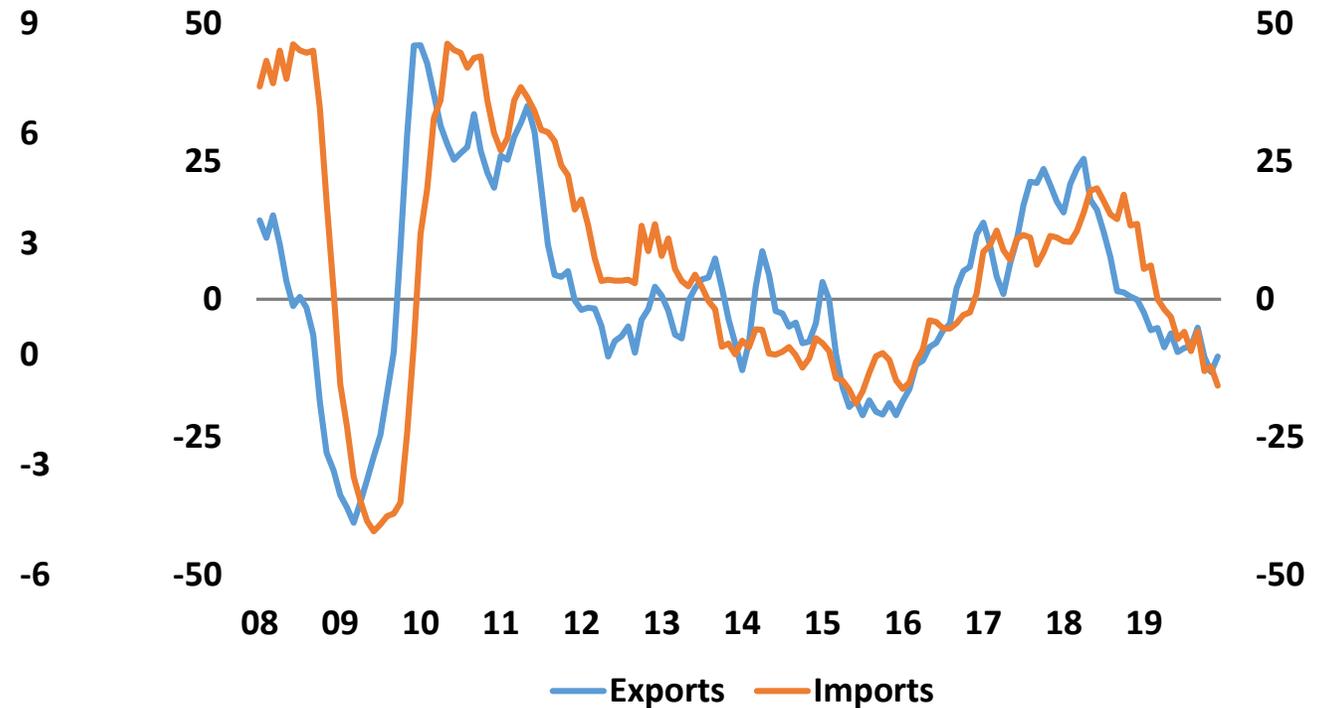
## Social unrest in Chile and its economic impact

And there have been direct impacts in activity (commerce, services, transportation) due to disruptions, followed by a significant drop in consumption and investment expenditures

**Monthly indicator of economic activity**  
(annual growth, percent)



**Foreign trade (\*)**  
(annual growth, percent)



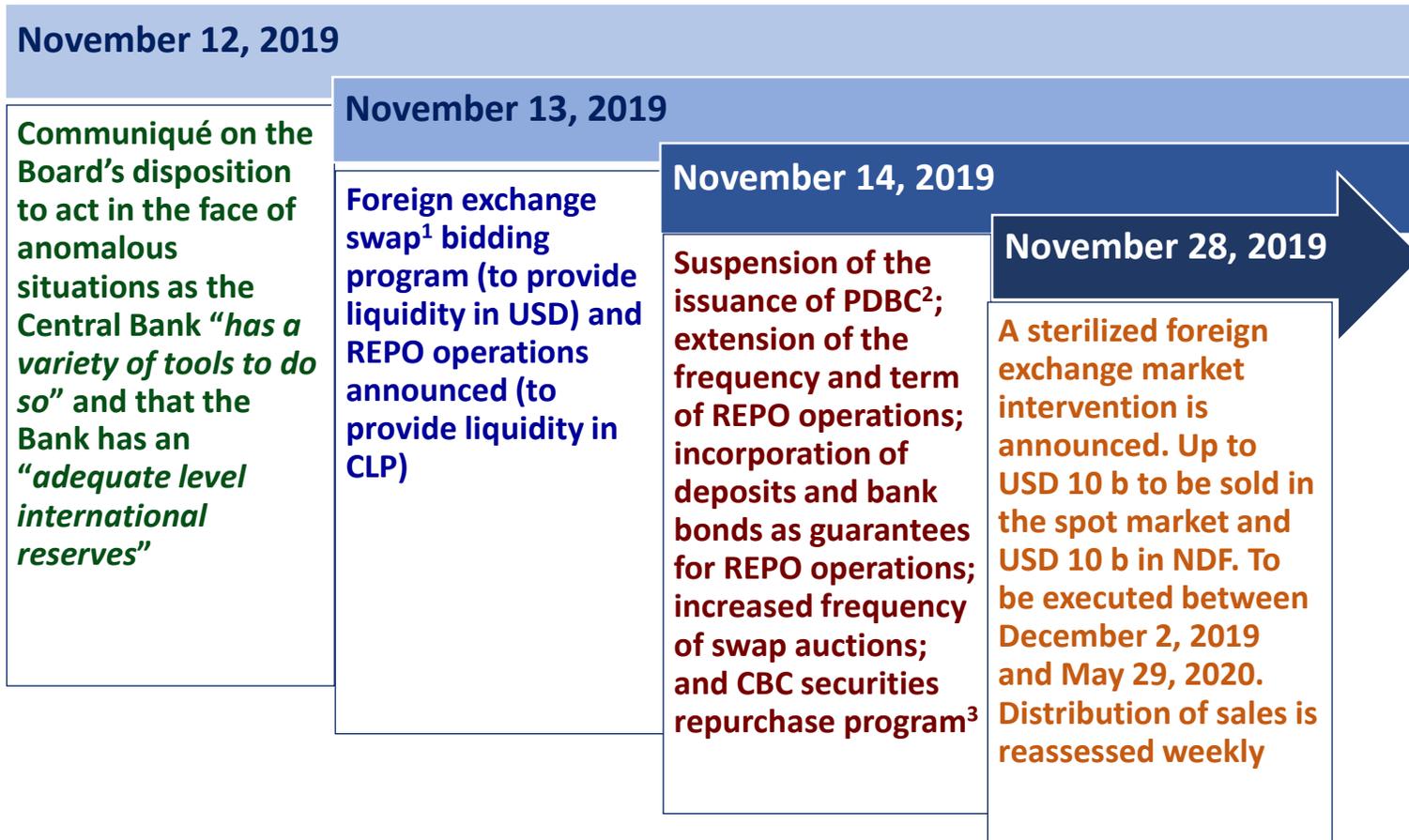
(\*) Quarterly moving averages. Source: Central Bank of Chile.

A semi-transparent globe is centered on the right side of the slide. It sits on a dark circular base. The background features a grid of light blue lines on a dark blue field, with some faint, larger-scale geometric patterns. The overall aesthetic is clean and professional.

## 2 The short-term policy responses

## Policy response: addressing the short-term impacts

# The Central Bank acted effectively to address the liquidity problems and the excessive volatility in the FX market



### FX Intervention schedule

#### Dec/02 to Dec/06

FX intervention program begins with the sale of US\$200 million daily in the spot market and another US\$200 million daily in 30-day no delivery forwards (NDF)

#### Dec/16 to Dec/20

Sale of US\$100 million daily in the spot market and another US\$300 million daily in 30-day NDF

#### Dec/23/2019 to Jan/03/2020

Sale of US\$50 million daily in the spot market and another US\$125 million daily in 30-day NDF

#### Jan/06 to Jan/10

No spot sales will be made and only 30-day NDF sales maturities will be renewed for US\$250 million daily from 07 to 10 January

#### Jan/13 to Jan/17

Spot sales will not be made and the existing NDF stock will be renewed, equivalent to US\$4.5 billion

**The CBC has sold 2,550 million of the 10 billion spot and 4,500 million of the 10 billion of NDF.**

(1) USD loan where the CBC sells spot and repurchases on the same day. (2) PDBC = *Pagaré Descontable de Banco Central*; short-term notes issued by the CBC. (3) Long-term debt issued years ago by the CBC for the sterilization of previous USD purchases (2008 and 2011).

## *Policy response: addressing the short-term impacts*

# Central Bank communication as a key policy tool

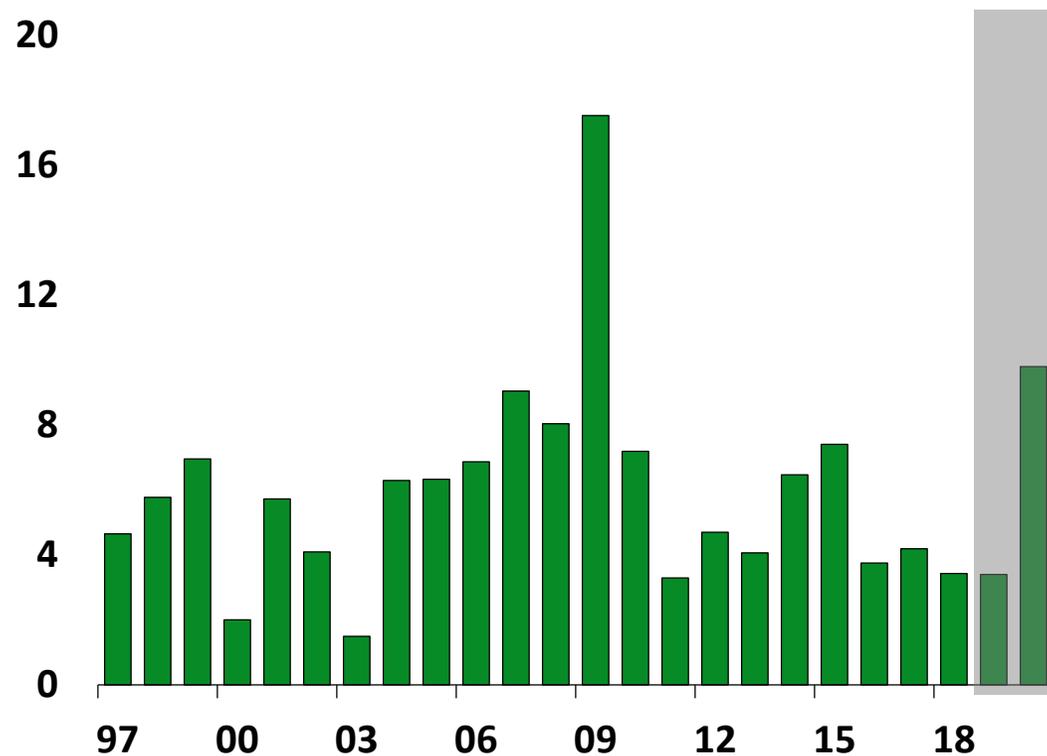
### Four main CBC communication events during the crisis:

- **Monetary Policy Meeting (Dec/4)**: warning of impacts in economic activity and inflation—kept MPR constant
- **Release of the *Financial Stability Report* (Nov/4)**: Special note explaining potential impacts on the financial system
- **Communication of liquidity provision measures and FX market intervention (Nov/13)**: focus in short-term stabilization does not change the overall FX and monetary policy framework
- **Release of the quarterly *Monetary Policy Report* and MP Meeting in December**: initial estimate of the short- and medium-term impacts of the crisis. Outlook marked by uncertainty coming from different sources, operating in different time horizons. Warning that existing buffers have been used to the limit.

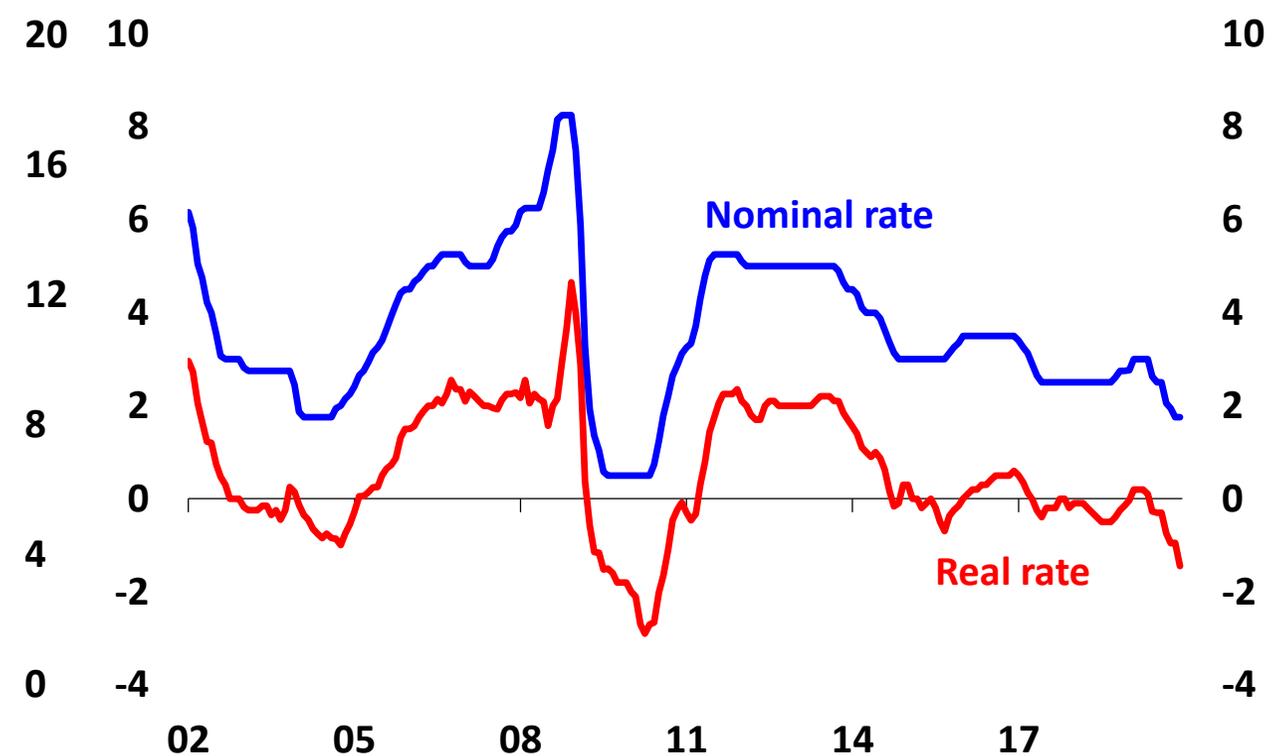
## Policy response: addressing the macroeconomic impacts

Fiscal policy will provide a boost to domestic demand while the CBC will provide monetary stimulus as far as the evolution of inflation allows

**Fiscal expenditure growth (1)**  
(real annual growth, percent)



**Real and nominal monetary policy rate in Chile (2)**  
(percent)

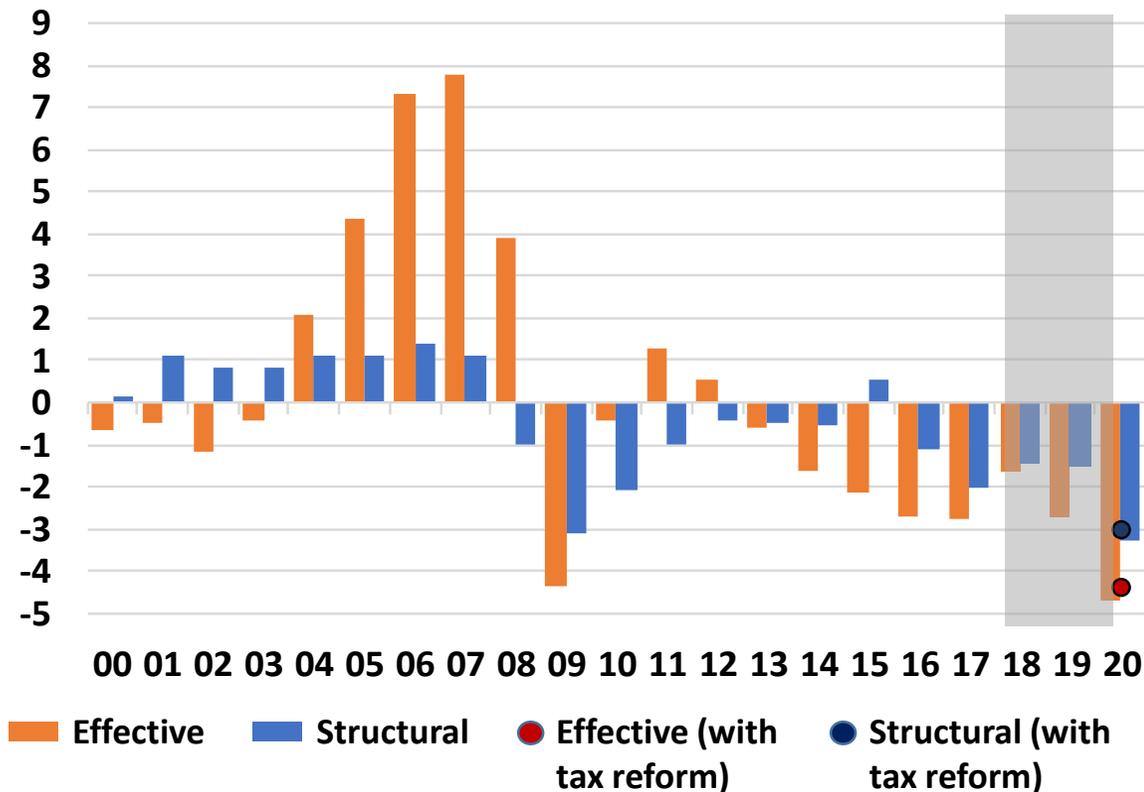


(1) Gray area shows forecast. (2) Calculated as nominal monetary policy rate minus one-year-ahead inflation expectations from the *Economic Expectations Survey*. Source: Central Bank of Chile based on Ministry of Finance data.

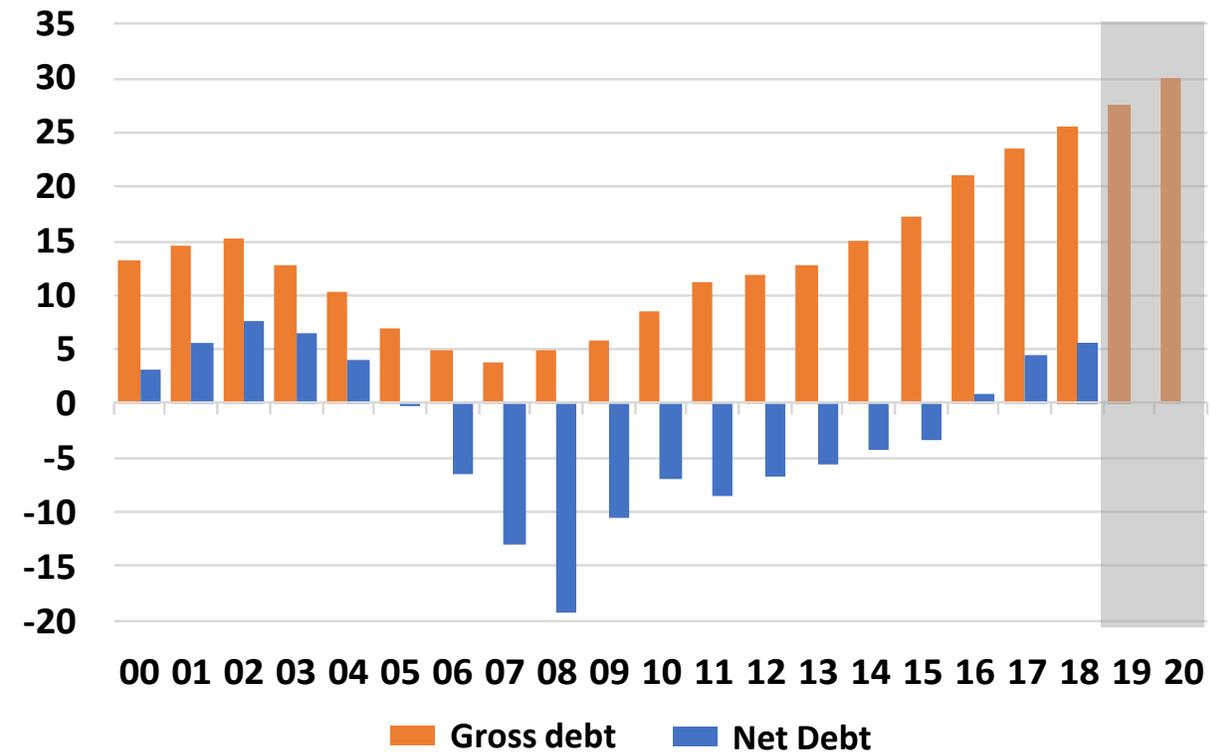
## Policy response: Impact on the fiscal position

Use of Sovereign Funds and larger deficits mean that the size of public debt will rise significantly

**Fiscal and structural balance (\*)**  
(percentage of GDP)



**Gross and net debt**  
(percentage of GDP)



(\*) "With tax reform" corresponds to projections including higher tax revenues. This reform is currently in legislative process and its financial report was entered on December 18, 2019. Source: Ministry of Finance, according to the Public Finance Report "Update of Fiscal Projections 2019-2024" (December 12, 2019).

## Policy response: reforms

# Unemployment insurance, strengthening of pensions, and anti-abuse agenda

### Unemployment Insurance reform

The *Unemployment Insurance Strengthening Project* was proposed:

- The parties can agree to a reduction of up to 50% of the working day. The remuneration will be adjusted in the same percentage and is complemented with up to 25% from the *Solidarity Unemployment Fund*.
- The requirements to access Unemployment Insurance are reduced, reducing the minimum number of contributions for indefinite (fixed) term contracts from 12 to 10 (6 to 5).
- It aims to increase the replacement rate by 10 percentage points in the Individual Unemployment Account and in the *Solidarity Unemployment Fund* for the first three (two) drafts of indefinite (fixed) contracts.

### Strengthening of pensions

#### **Dec/06: Strengthening of the *Solidarity Pillar***

- Increase in Basic Solidarity Pension (PBS) and Maximum Pension with Solidarity Contribution (PMAS); PBS and Solidarity Pension Provision (APS) for Disability; Guaranteed Solidarity Pension; creation of Notional Accounts; and Surplus Requirements for Free Disposition.

#### **Jan/15: A bill will be sent this week to Congress**

- It includes an additional 6% contribution from the employer.
- Pension system based on three pillars, the State-funded Pillar, the Individual Savings Pillar, and the Collective and Solidarity Savings Pillar, financed by employers and with an initial contribution from the State.
- Two additional Contributions are created to the Pension Savings: a contribution of 3% additional and gradual, which will be added to the current 10%, and a Collective and Solidarity Savings Fund is created, with an additional and gradual contribution of 3%; both from the employer.

### Anti-abuse agenda

The Fair Treatment, Dignity, and Anti-Abuse Agenda, relies on three fundamental pillars:

- Fight more severely collusions and market abuse, tax crimes and the use of inside information.
- *Better protection of consumer rights.* Greater ease for closing contracts, establishment of an Online Consultation System on the status of contracted insurance, more transparent terms and conditions in electronic commerce, elimination of unnecessary notarial procedures, and establishment of Financial Portability to avoid abuse of captive customers
- *Better protection of workers' rights.* Modernization of the Labor Supervisor.

*Policy response: political reforms (Law 21.200, published in the Official Gazette, December 24<sup>th</sup>, 2019)*

A Constitutional amendment has already been passed establishing a procedure to draft a new Constitution in the coming two years, with rules to provide ample legitimacy to the outcome

### Timeline of the Constitutional process



## Policy response: legal and institutional changes to strengthen control of public order

There is wide agreement that all changes will require a restoration of public order.

### Legislative Agenda for Security and Social Peace

#### Bill of law to Strengthen and Modernize the State Intelligence System (SIS)

1. Presented by the Executive to the Senate of Congress Nov. 13<sup>th</sup>, 2018.
2. Currently being discussed at the Finance Commission of Senate. If approved, it shall pass to the Lower Chamber.
3. Bill aims to provide a more robust SIS in order to render proper and timely advice to the Executive.

#### Reorganization and strengthening of protocols and police training

1. Presented by the Executive to the Senate of Congress Nov. 20<sup>th</sup>, 2018.
2. Bill aims to modernize the institutional direction and management of police forces

#### Anti-loot and anti-barricades Bill of law

1. Presented by a group of Deputies, Nov. 25<sup>th</sup>, 2019.
2. **Approved by Congress.** January 16<sup>th</sup>, 2020.
3. Defines looting and other conducts that limit people's freedom to circulate at public spaces, using violence or intimidation as criminal acts, establishing penalties depending in the seriousness of the conduct .
4. Such penalties are aggravated, for robbery crimes amid situations of public calamity or serious alteration to order (3 to 5 years of imprisonment).

#### Bill of law that enhance sanctions to public disorders felony ("*anticapuchas*")

1. Presented by a group of Senators, Sept. 4<sup>th</sup>, 2019.
2. Admitted for discussion by the Senate in January 2020. Currently being discussed at the Public Security Commission of Senate.
3. Bill aims to raise sanctions to this felony, during public acts,, affecting public order or causing damage to persons or property.

3

## Economic prospects



## Economic prospects

2020 projections for growth were cut down from a range centered in 3.25% to one centered in 1%. There is a modest recovery in 2021, but growth remains below the previous forecast

### Domestic scenario

(annual change, percentage)

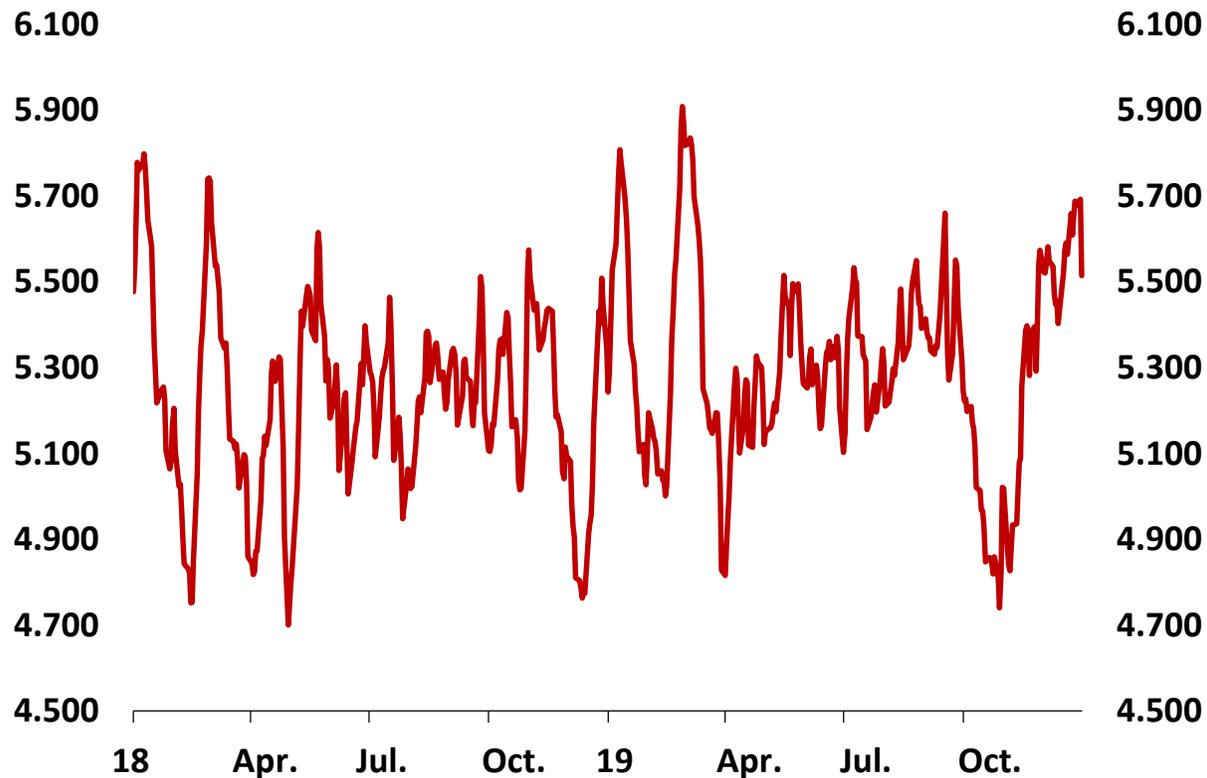
	2018	2019 (f)		2020 (f)		2021 (f)	
		Report Sep.19	Report Dic.19	Report Sep.19	Report Dic.19	Report Sep.19	Report Dic.19
GDP	4.0	2.25-2.75	1.0	2.75-3.75	0.5-1.5	3.0-4.0	2.5-3.5
Mining GDP	5.2						
Non-mining GDP	3.9						
Domestic demand	4.7	2.4	0.3	3.5	-1.6	3.6	4.1
Domestic demand (w/o inventory change)	3.9	3.0	1.4	3.3	0.0	3.6	3.1
Gross fixed capital formation	4.7	4.0	2.5	4.0	-4.0	4.1	3.2
Total consumption	3.7	2.7	1.1	3.1	1.1	3.4	3.1
Goods and services exports	5.0	-1.3	-1.1	1.6	2.2	2.2	2.2
Goods and services imports	7.6	-1.9	-3.8	2.3	-7.3	2.0	5.5
Current account (% of GDP)	-3.1	-3.3	-2.9	-3.1	-0.2	-2.6	-0.8
Gross national saving (% of GDP)	19.6	19.3	19.6	19.9	19.9	20.6	20.1
Gross fixed capital formation (% of nominal GDP)	21.3	21.9	22.0	22.1	21.1	22.1	21.0

(f) forecast. Source: Central Bank of Chile.

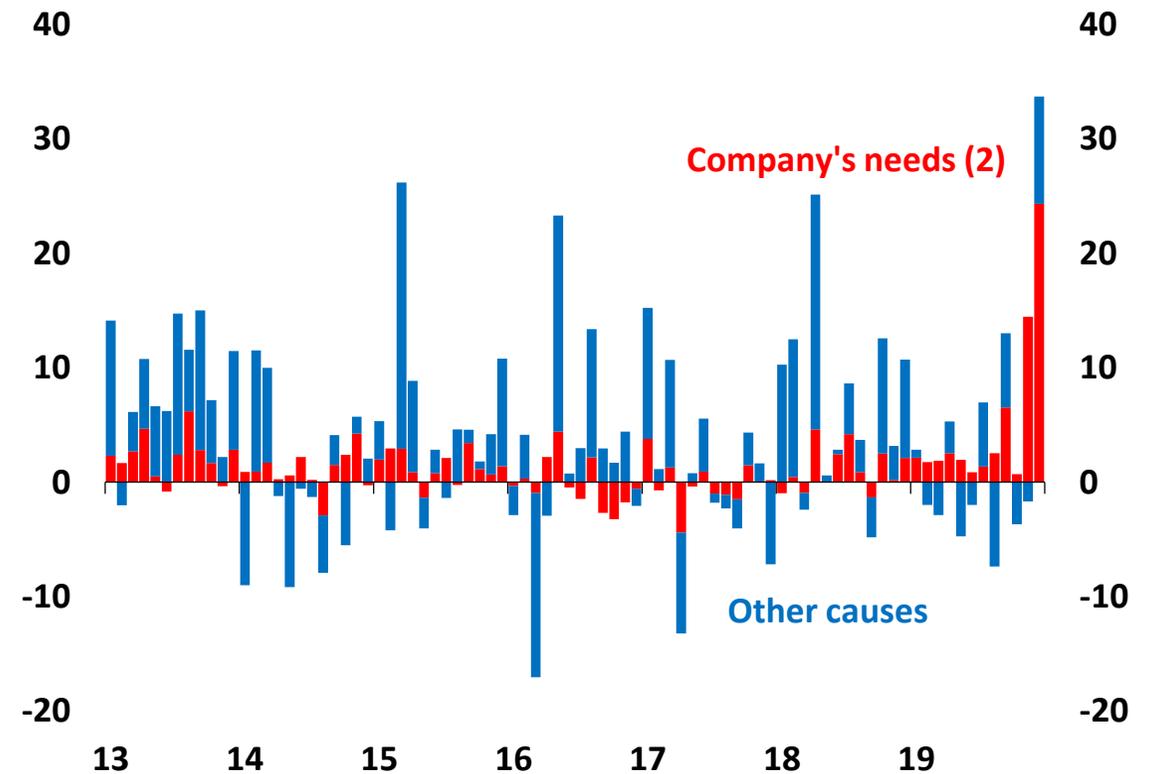
## Economic prospects

Consumption will be affected by the fall in consumers confidence and a weakening in the labor market

**Requests for unemployment benefits**  
(number, seasonally adjusted)



**Dismissal letters by cause (1)**  
(contribution to annual change, percentage points)



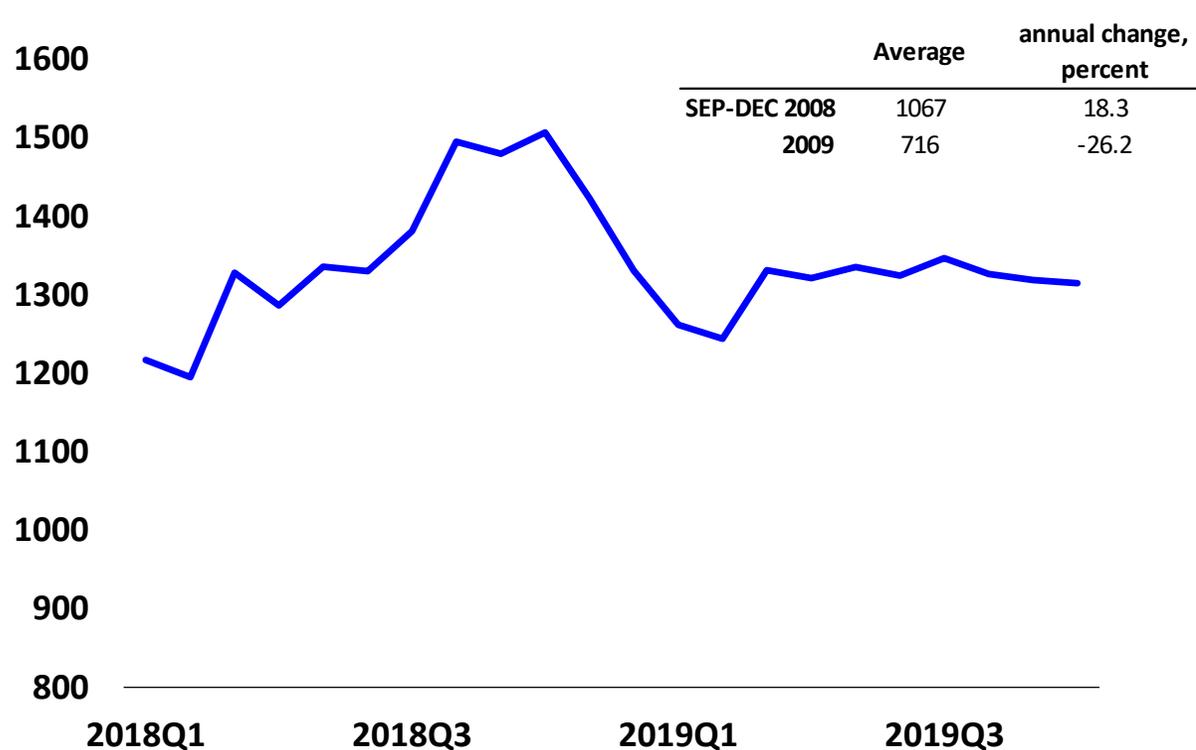
(1) For December 2019, considers information as 30<sup>th</sup>. (2) Considers article 161, subsection 1 and 2. Source: Ministry of Labor and Social Security.

## Economic prospects

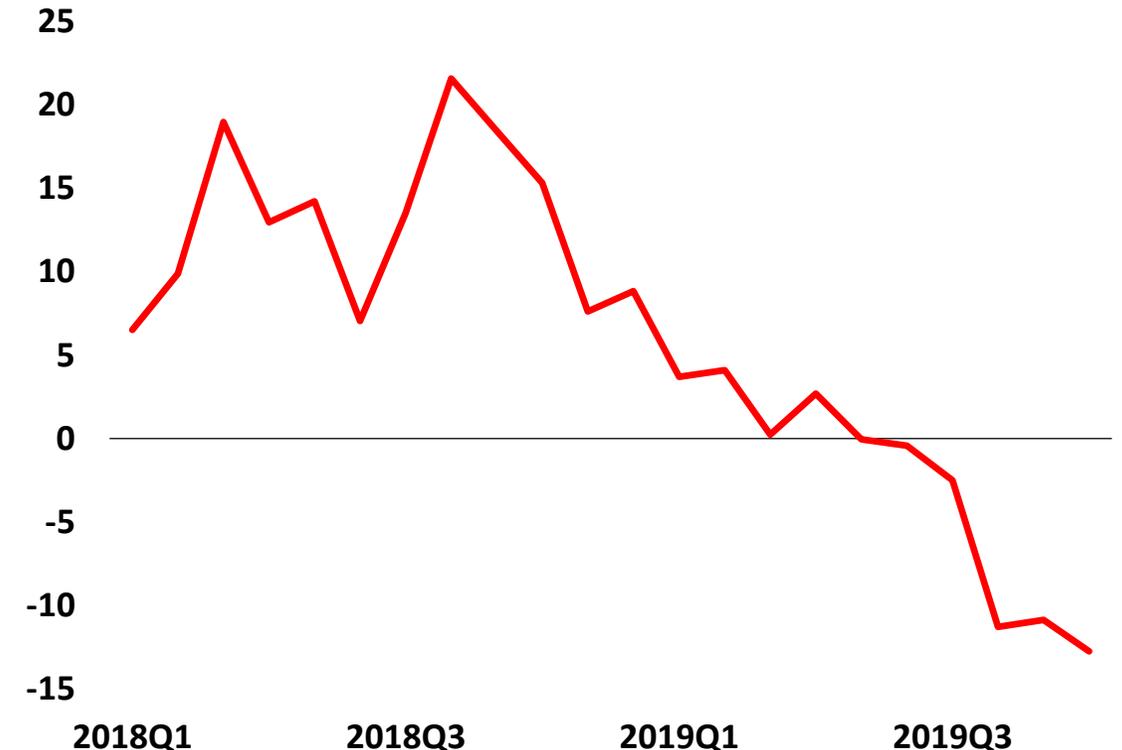
Projects in the mining and manufacturing sectors have carried on as initially planned. However, private non-mining investment projects have been either delayed or called off

### Capital goods imports (1)(2)

(millions of 2013 USD)



(annual change, percent)

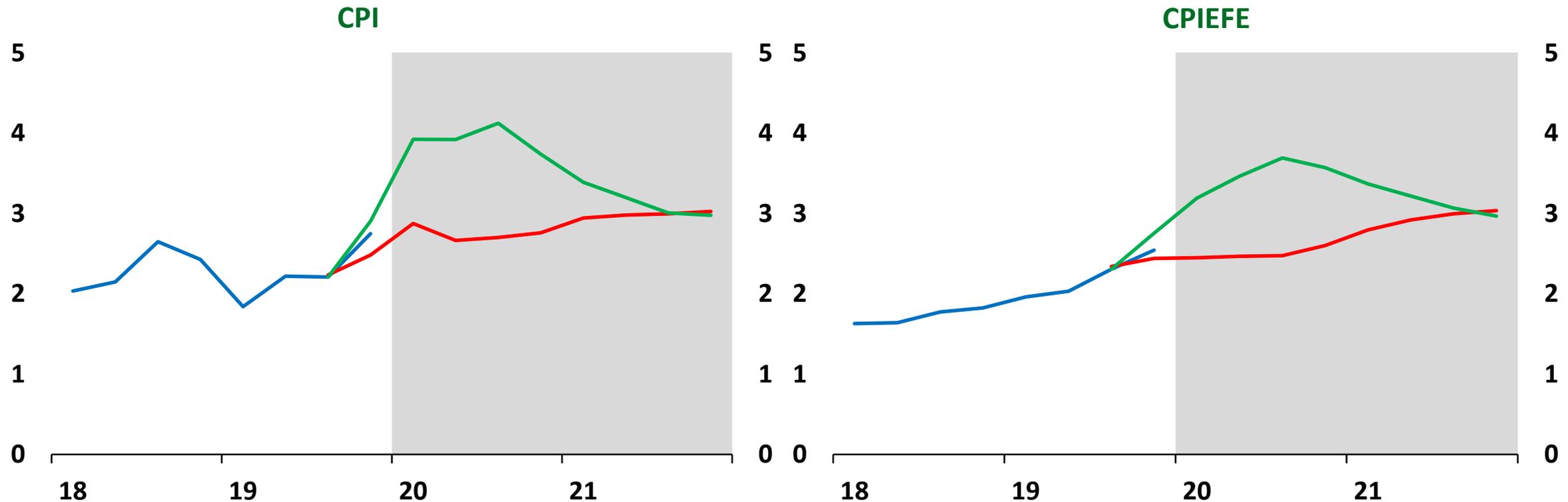


(1) Quarterly moving averages. (2) Series deflated by the capital goods import prices index, with base year 2013=100 spliced with the base year 2008=100 using annual changes. For the fourth quarter of 2019, the level of the third quarter of 2019 is used.. Sources: Central Bank of Chile

## Economic prospects

During the second and third quarters of 2020, headline inflation would be close to 4%, while core inflation would rise to just over 3.5% by mid-year in response to the depreciation of the peso

**CPI inflation forecast (1)(2)**  
(annual change, percentage)



(1) For 2018, the annual variation of CPI and CPIEFE are obtained by splicing the 2013=100 series with the monthly variations of the 2018=100 basket, starting in February 2018. See Box IV.1, the *Monetary Policy Report* of March 2019. (2) Gray area corresponds to forecast included in the *Monetary Policy Report* of December 2019. Sources: Central Bank of Chile and INE.

## *Economic prospects*

# Main risks to this scenario

December's projections were carried out at the moment of highest uncertainty. They were based on the assumption of a restoration of public order and gradual recovery of confidence along the Constitutional process.

- The main risks to the baseline are domestic:
  - Public unrest and violent actions restart and introduce uncertainty about the Constitutional process,
  - Business and consumers confidence takes longer to recover,
  - New legislation might increase costs (taxation, labor costs) with larger adverse effects on employment, inflation and activity,
  - On the positive side, quick advances in key legislation (control of public order, tax reform and pensions reform) might help to limit uncertainty and facilitate a fastest improvement in confidence that might help a fastest recovery.
- On the longer term prospects it is too early to tell. Some key issues to focus on are:
  - Changes in trend growth (productivity, migration),
  - Institutional changes that might affect effectiveness of institutions (either direction).

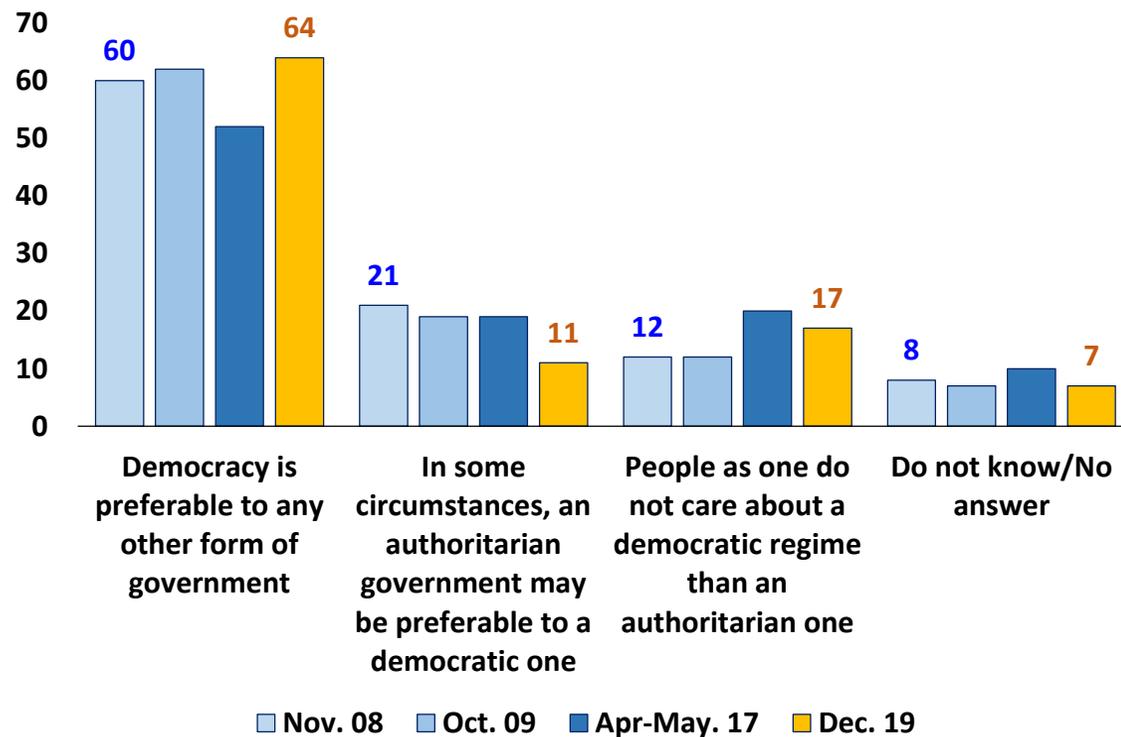
## 4 Concluding remarks



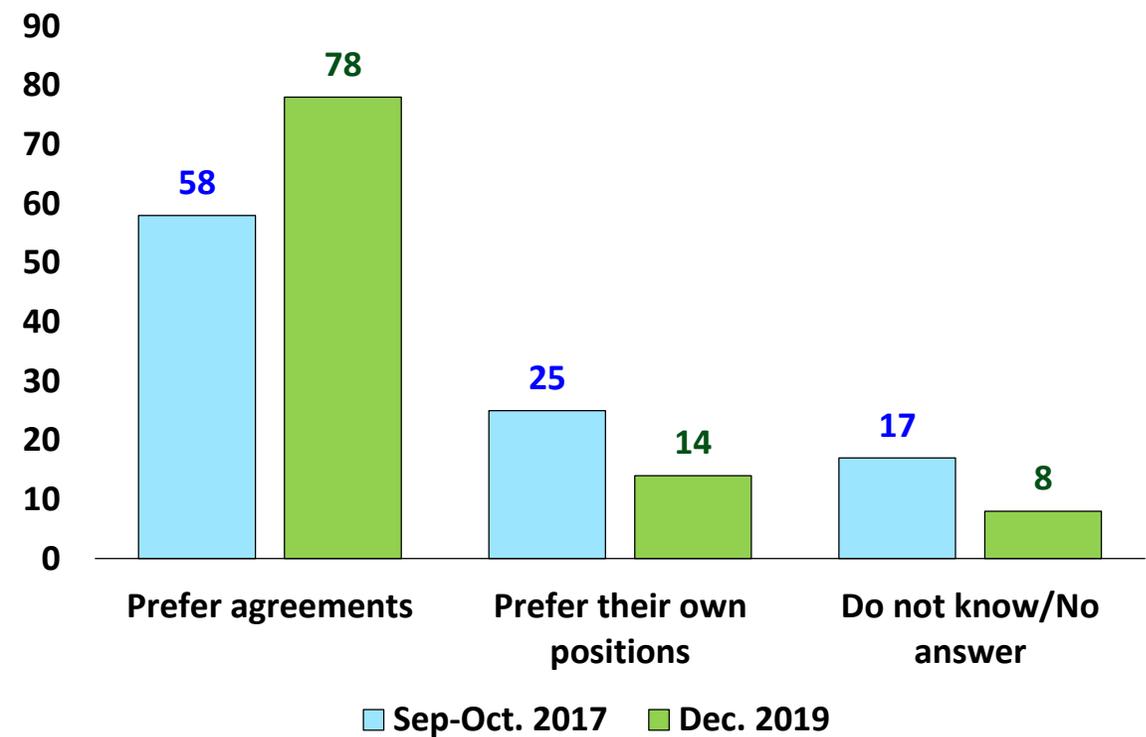
# Not all news from the CEP Survey are bad

Chileans value democracy *more* than before (even though they think it is working worse) as well as appreciate reaching political agreements

### Valuation of democracy in Chile (\*)



### How politicians should act?

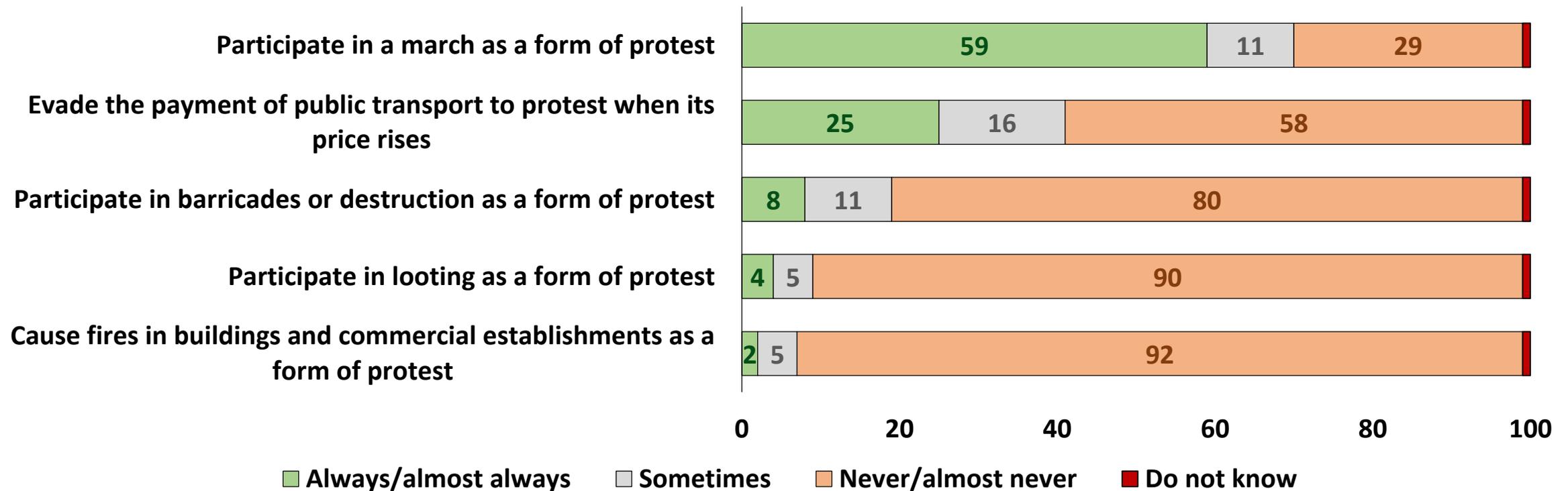


(\*) % of the sample responding positively. Source: CEP Survey, December 2019.

# Not all news from the CEP Survey are bad

## Chileans do not validate violence in protests

How often would you justify or not the following actions? (\*)



(\*) % of total sample. Source: CEP Survey, December 2019.

## *Concluding remarks*

# Biggest political and economic test of Chilean Institutions since the return to democracy

- Very large and unexpected shock. Many issues under question. Widespread violence has had a significant impact on public confidence.
- Economic policies have neutralized potentially larger negative effects in the short run.
- However the economy will slow down drastically in 2020.
- In the medium term the critical variable for the timing and speed of the recovery will be the reduction of uncertainties. This falls in the realm of politics.
- One positive note (so far): Economic policy reactions have been quick and appropriate, inflation expectations remain aligned with target and monetary policy has room to act. The political system has performed reasonably well, after an initial period of huge confusion.
- One note of caution: The buffers to absorb large macroeconomic shocks have been spent in the last decade, and their reconstruction will require a sustained effort in the coming years.

# Social Unrest and Economic Performance in Chile



Joaquín Vial  
*Deputy Governor  
Central Bank of Chile*

6<sup>th</sup> BBVA Latin America Conference. January 20, 2020 – London, England