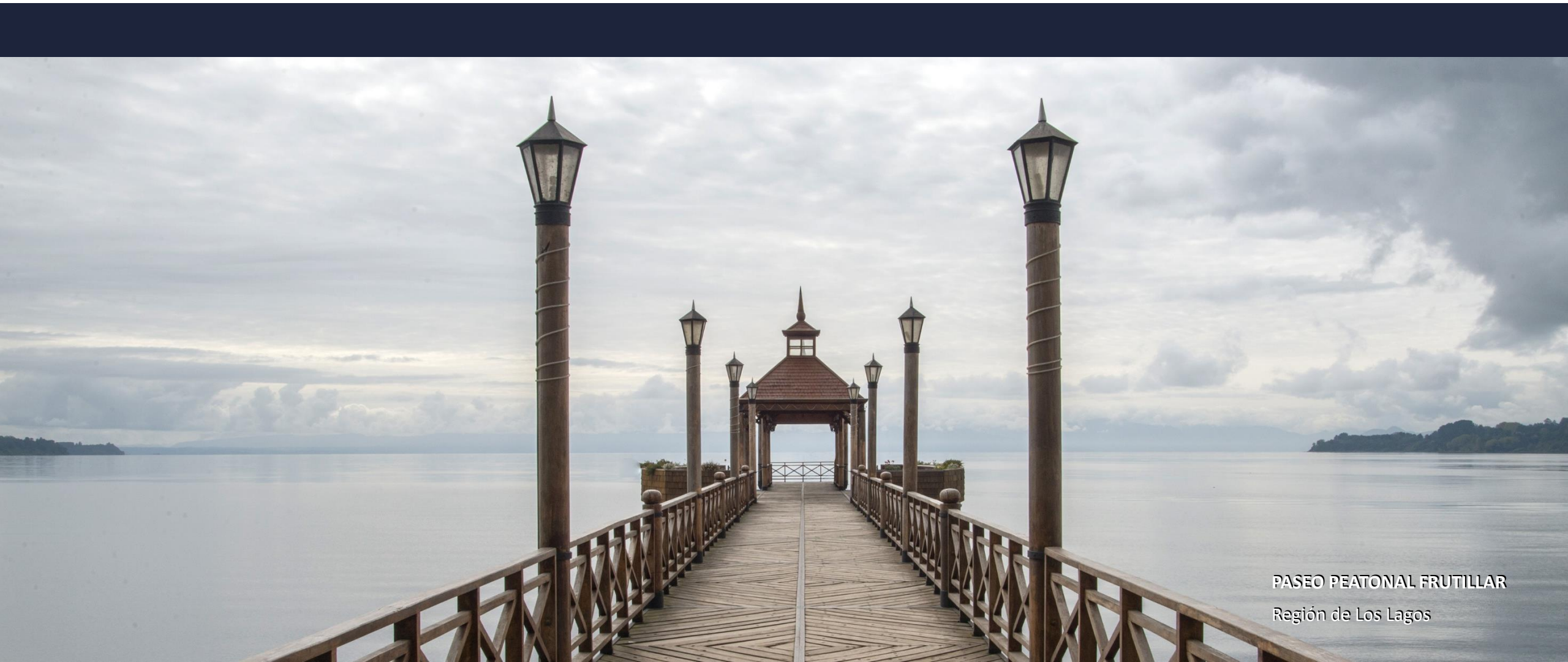


# MONETARY POLICY REPORT

MARCH 2023

Luis Felipe Céspedes, Board Member



PASEO PEATONAL FRUTILLAR  
Región de Los Lagos

# Monetary policy at the Central Bank of Chile



Money plays a fundamental role in the proper functioning of every economy. To preserve that role, monetary policy must protect the value of the national currency, the peso, by seeking to keep inflation low and stable. Achieving this promotes people's well-being by safeguarding the purchasing power of their earnings and helping the economy to function better. When inflation is low and stable, monetary policy can also moderate fluctuations in employment and production.

The Central Bank of Chile conducts its monetary policy seeking that, irrespective of the current level of inflation, its projection over a two-year horizon should be 3%. This is similar to what is done in other countries that, like Chile, have a floating exchange rate, and is known as inflation targeting regime.

The Monetary Policy Rate (MPR) is the main instrument used by the Bank to achieve the inflation target. Its level is decided at every Monetary Policy Meeting, which is held eight times a year. In practice, the MPR is a benchmark interest rate that determines the cost of money and other financial prices, such as the exchange rate and longer-term interest rates. These variables, in turn, affect the demand for goods and services and, hence, prices and inflation. Monetary policy decisions take several quarters to be fully reflected in the economy, which justifies that monetary policy should be made with a forward-looking view, having as its primary focus the two-year inflation projection and not just today's inflation.

Since the Central Bank makes its monetary policy decisions autonomously, it must constantly account for them and their results to the general public. This is so not only because it is a government agency in a democratic society, but also because a credible monetary policy understood by the people keeps inflation low and stable. Through the Monetary Policy Report (MPR), the Bank communicates to the general public its view of the recent evolution of the economy, its projections for the next few years and the way in which, in this context, it will manage monetary policy to meet the inflation target.

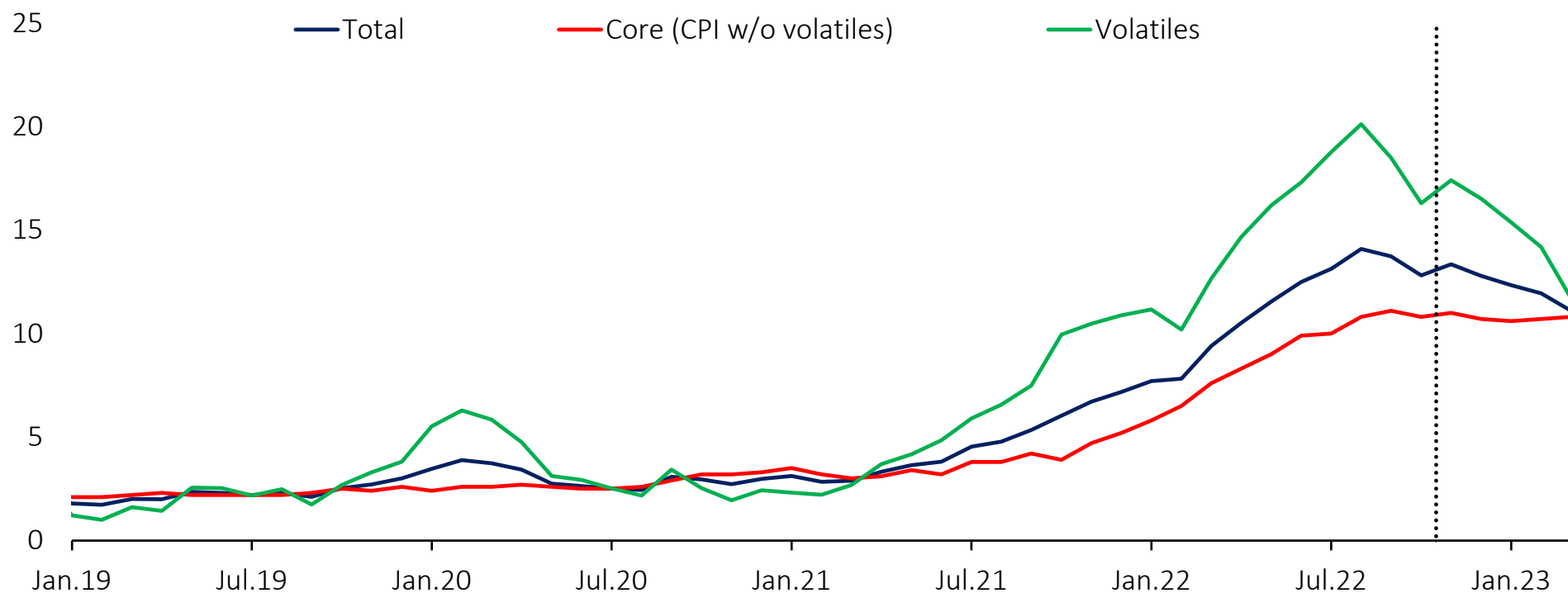




Inflation remains very high, despite declining gradually over recent months. The most recent release (march) confirms that core inflation has remained at a high level for several months.

## Inflation indicators (1)(2)

(annual change, percent)

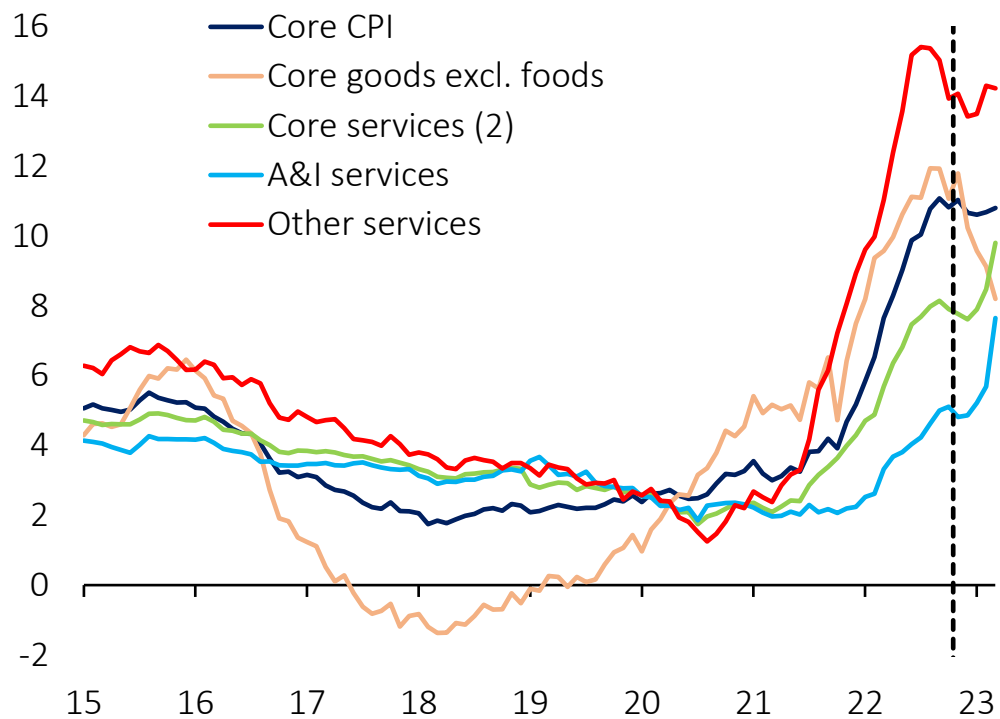


(1) Dotted vertical line marks statistical cut-off of December 2022 MP Report. (2) For details on groupings and their shares in total CPI basket, see [box IV.1 in December 2019 MP Report](#), [Carlomagno and Sansone \(2019\)](#), and [Economic Glossary](#). Sources: Central Bank of Chile and National Statistics Institute.

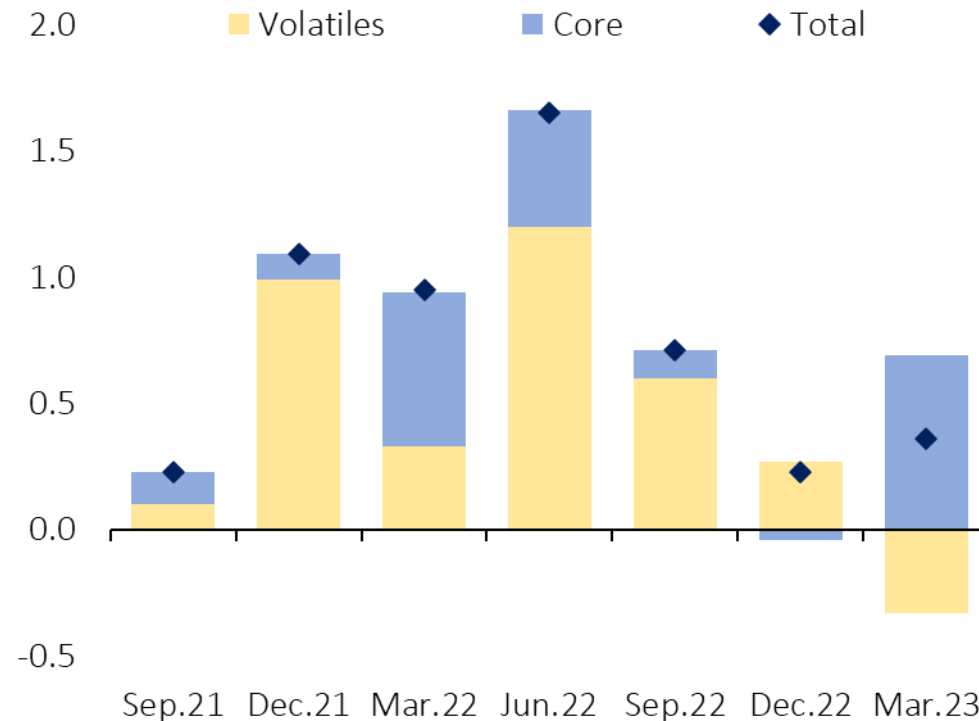
# Inflation's core component is main cause of (upward) inflationary surprises since the last MP Report.



**Core inflation (1)**  
(annual change, percent)



**Inflationary surprises by components (3)**  
(percentage points)



(1) Dotted vertical line marks statistical cut-off of December 2022 MP Report. (2) Sum of Administered and indexed services and Other services. (3) Cumulative surprises in respective MP Reports. Sources: Central Bank of Chile and National Statistics Institute.

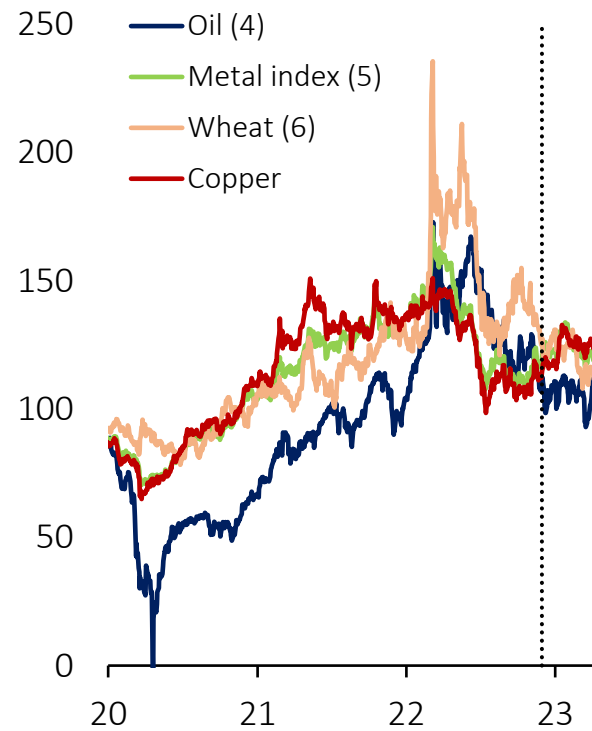
This occurs despite improvement in several inflation fundamentals, such as a significant exchange rate appreciation, declining commodity prices, and eased logistic problems around the world.



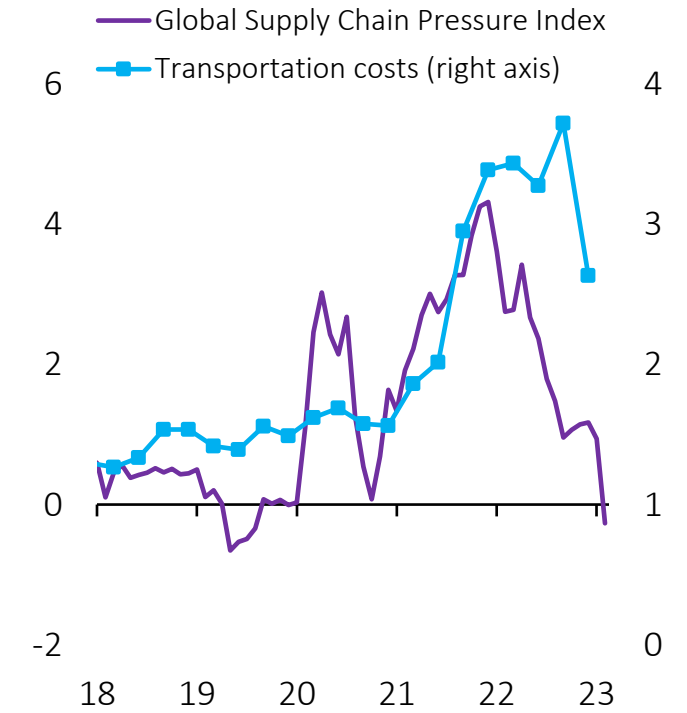
Real exchange rate (RER) (1)(2)  
(index, 1986 average=100)



Commodity prices (3)  
(index, 2010-2023 average=100)



Cost factors evolution (7)  
(percent of GDP, quarterly; st. deviation of historic average, monthly)

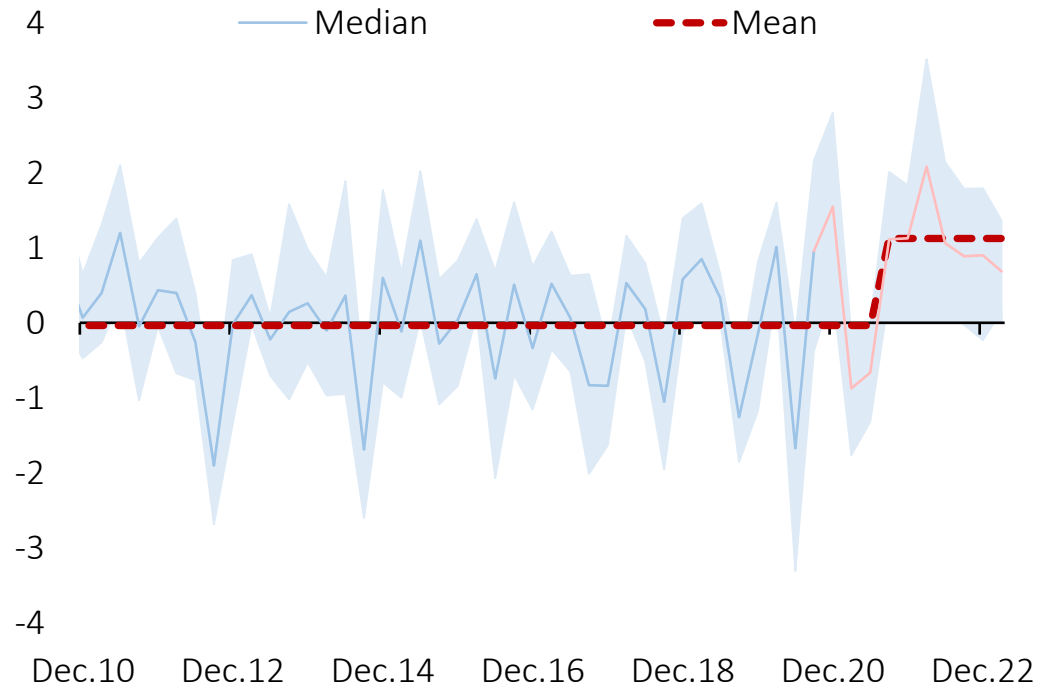


(1) March 2023 figure is preliminary average of the month. (2) Average of the last 15 years covers the period Apr.2008-Mar.2023 (3) Dotted vertical line marks statistical cut-off of December 2022 MP Report. (4) WTI-Brent average. (5) S&P GSCI Industrial Metals. (6) One-month futures price. (7) Transportation cost is calculated as the difference between CIF and FOB imports. Sources: Central Bank of Chile, Bloomberg, and New York Federal Reserve.

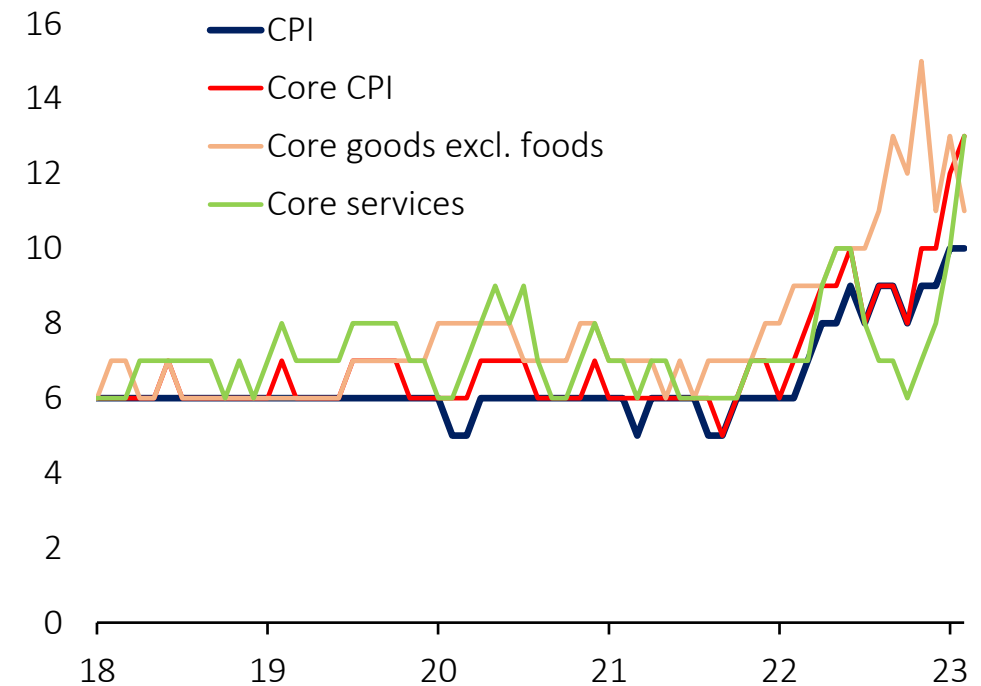
On one hand, the persistency of core inflation coincides with a string of events of great magnitude and infrequent occurrence in recent years.



Estimated demand shocks (\*)  
(standard deviations)



Mean duration of CPI shocks  
(months)



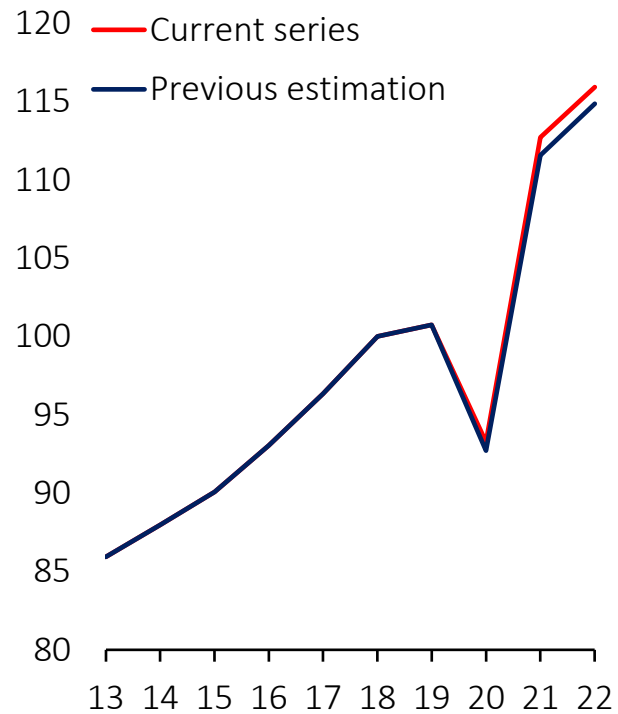
(\*) Bands are 25th and 75th percentiles.  
Source: Barrero *et al.* (2023).

Additionally, the imbalances accumulated by the economy were larger than expected. While the level of output and demand did not change substantially with a recent national account revision, the composition did, in favor of consumption.

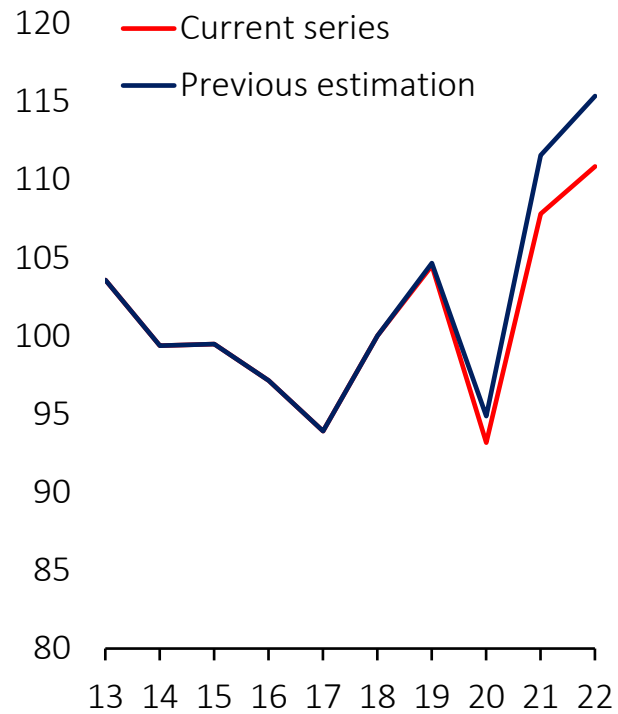


Domestic demand (\*)  
(index, 2018=100, real series)

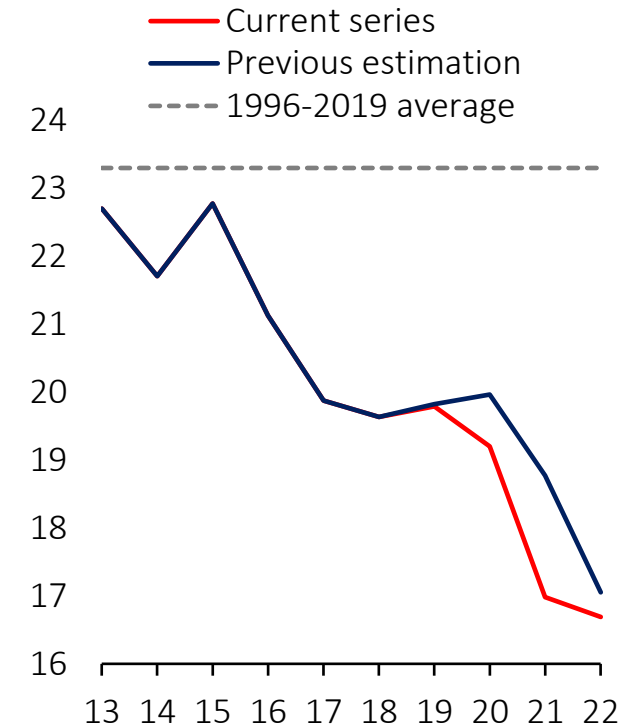
a) Private consumption



b) Investment



National savings  
(percent of nominal GDP)



(\*) Original real series. For 2022.Q4 of the previous estimation series (available up to 2022.Q3), the annual change in the currently published series is used.  
Source: Central Bank of Chile.

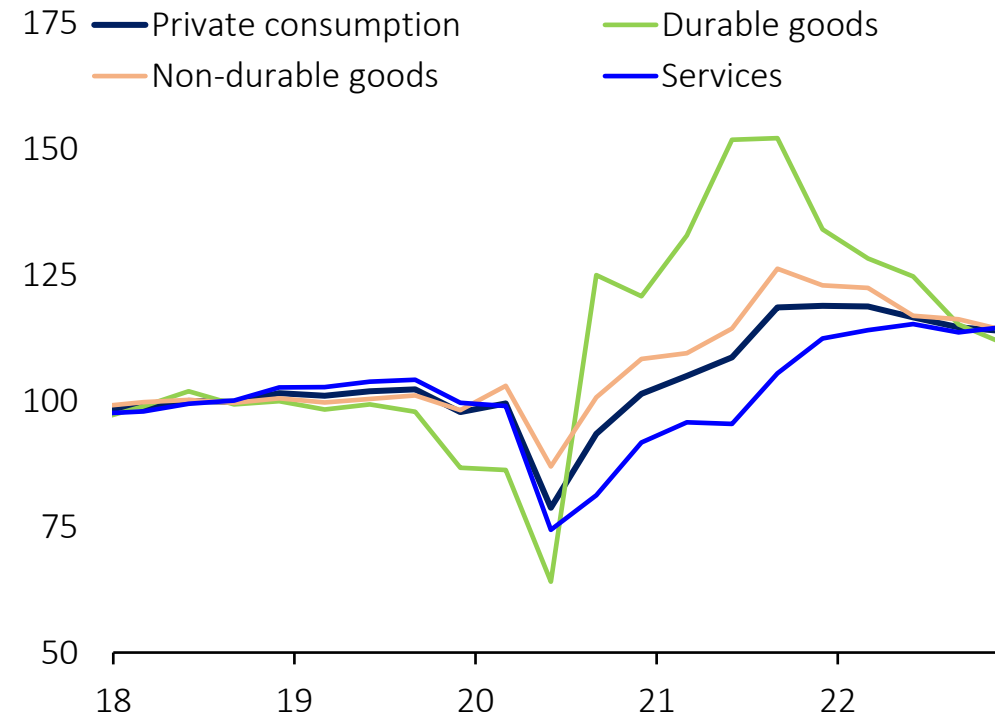


# Household consumption has declined but at a lower rate than expected.



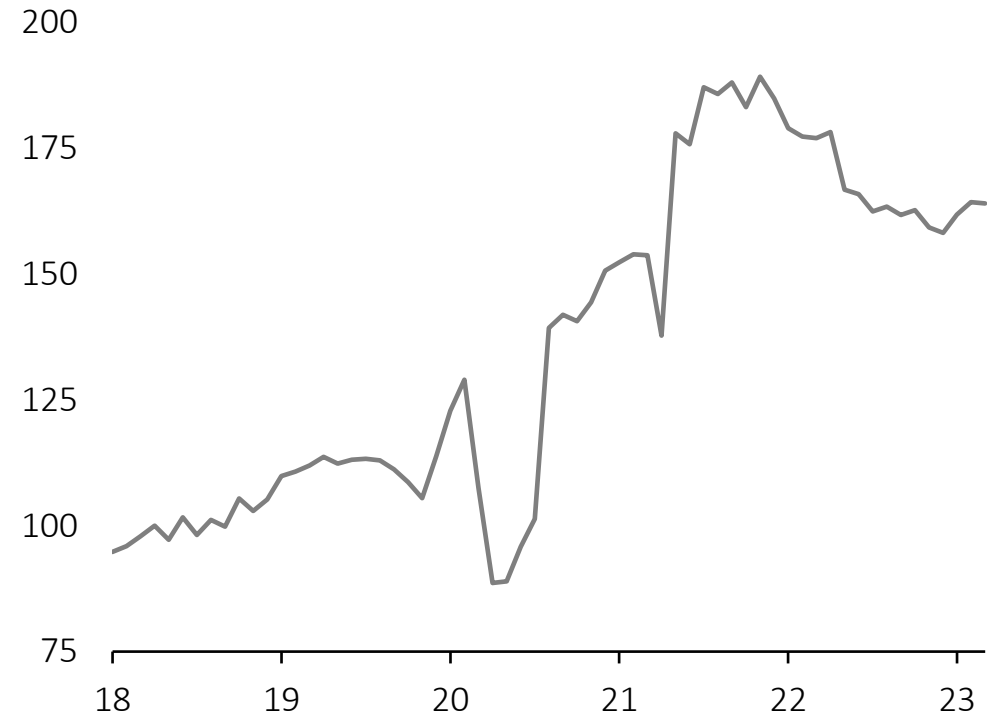
## Private consumption

(index, 2018=100, deseasonalized series)



## Spending in goods and services (\*)

(index, 2018=100, real deseasonalized series)



(\*) Sales to residents. Subject to revision.

Sources: Central Bank of Chile and Transbank.

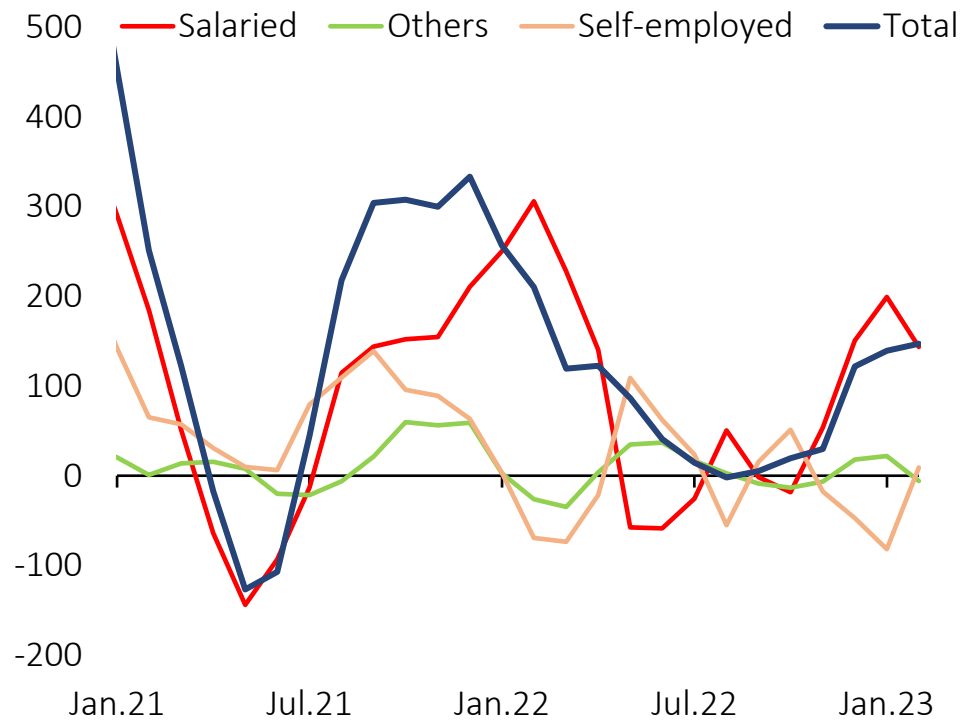


This coincides with a recent rise in employment, which has contributed to a slight rebound of the wage bill.



### Job creation by categories (1)

(cumulative in three months, thousands of persons)



### Real wage bill (2)

(percent, contributions to monthly change, deseasonalized)



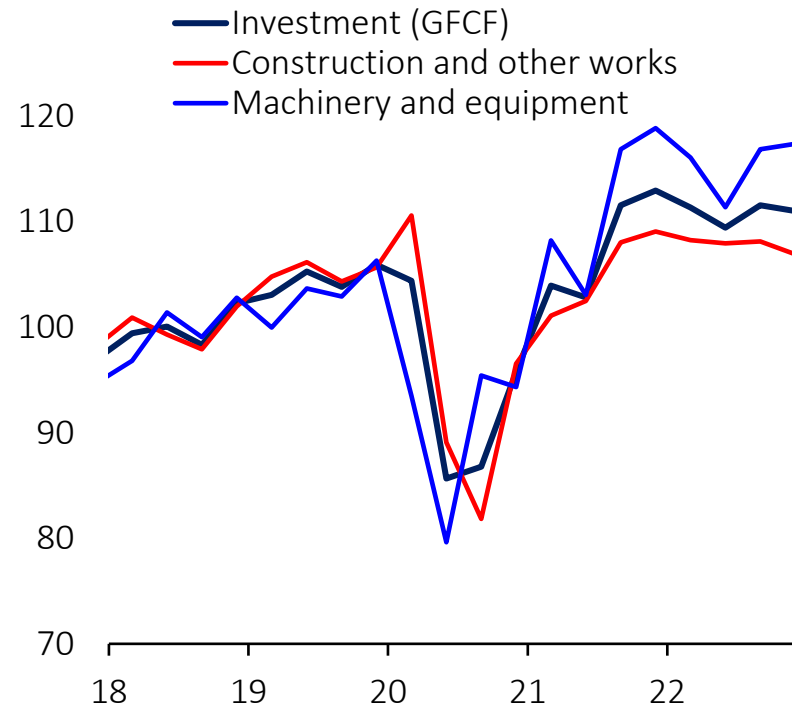
(1) Total includes self-employed workers, salaried employees, employers, household help and unpaid family members. (2) Calculated based on deseasonalized series of real labor cost, usual hours worked and occupation. Sources: Central Bank of Chile and National Statistics Institute.

# Investment remains sluggish and several related indicators reflect weak performance.



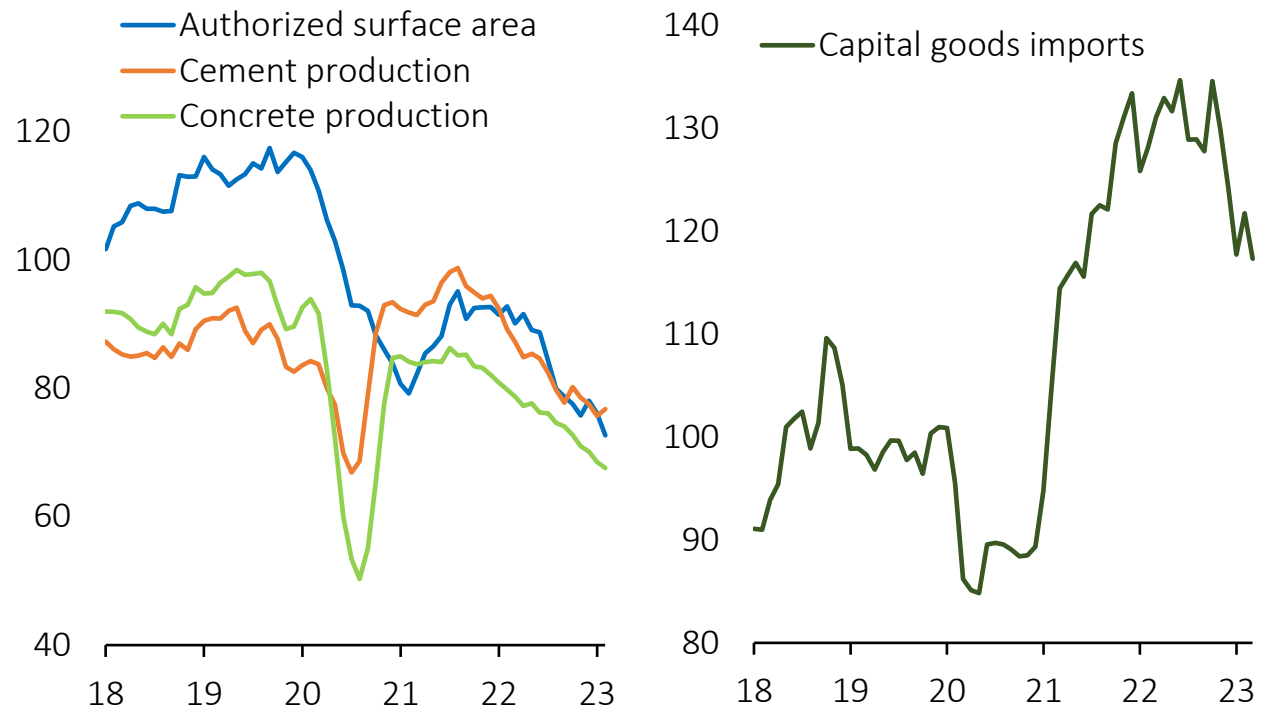
## Investment (GFCF)

(index, 2018=100, deseasonalized series)



## Investment-related indicators (1)(2)(3)

(index, 2013=100; index, 2018=100)



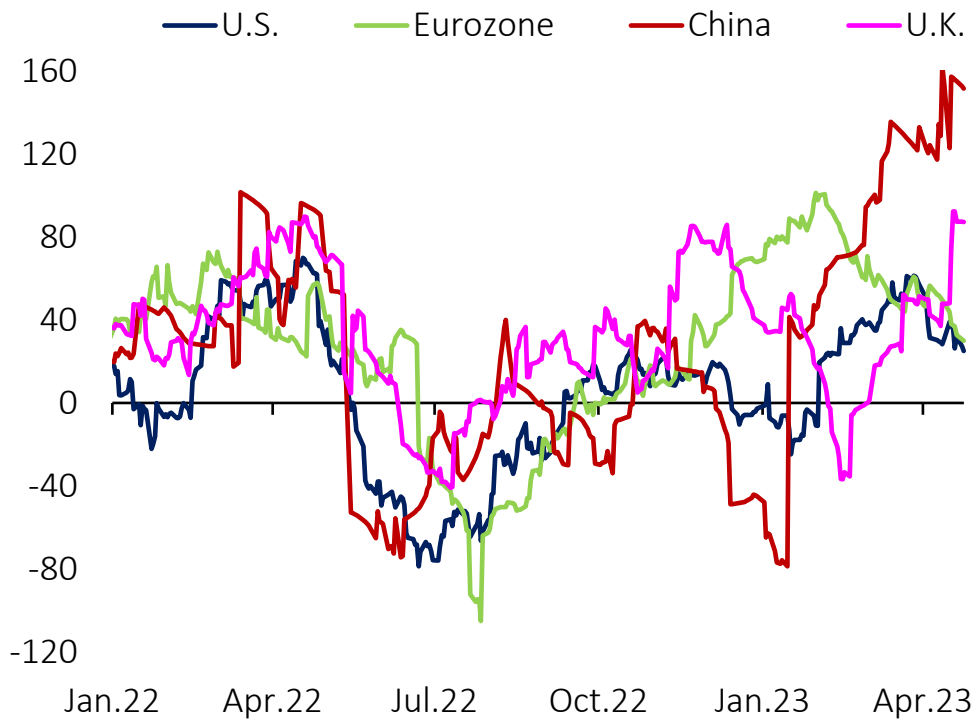
(1) Seasonally adjusted. (2) Authorized surface area is in annual moving average. Cement and concrete production is measured by the Index of Industrial Production (IPI) and in quarterly moving averages. (3) Capital goods imports series measured using quarterly moving average.

Sources: Central Bank of Chile and National Statistics Institute.

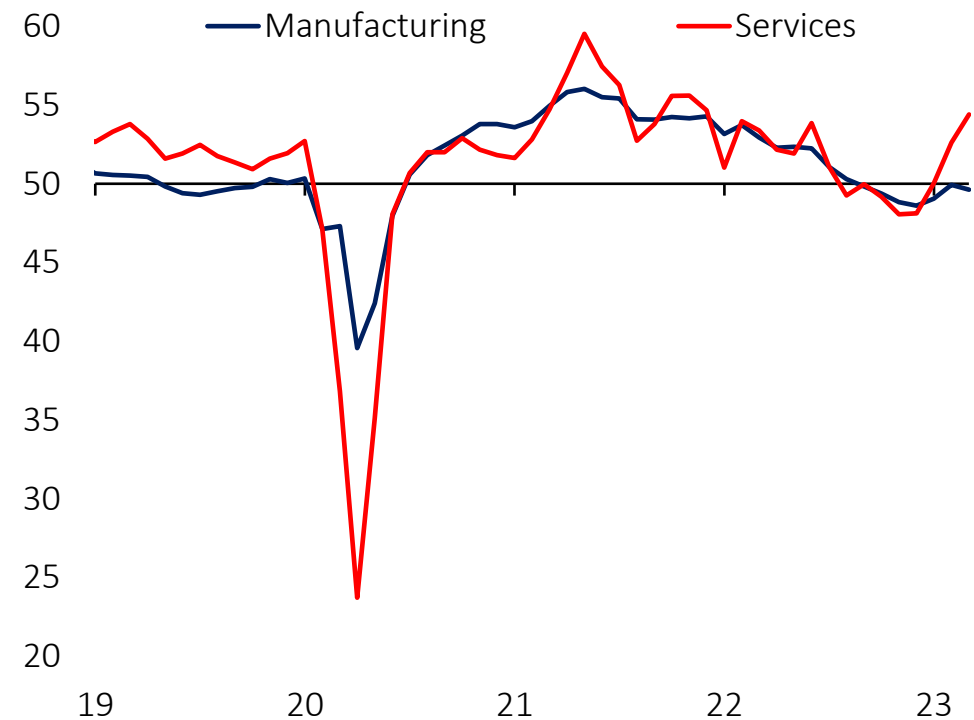
Global conditions resemble Chile's in several aspects. Recent economic activity indicators in large economies have been better than expected and services show increased dynamism.



Economic surprises (Citi)  
(index)



Business expectations (PMI Global)  
(index, deseasonalized series)



Sources: Bloomberg and JPMorgan.

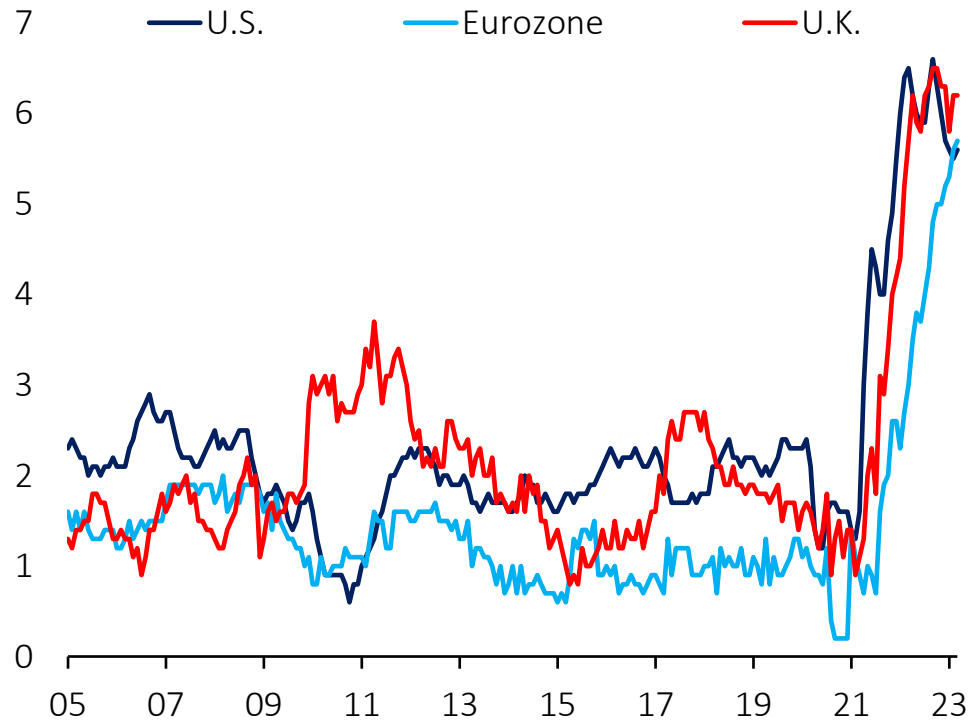
# Global inflation remains high and core component indicates higher persistency.



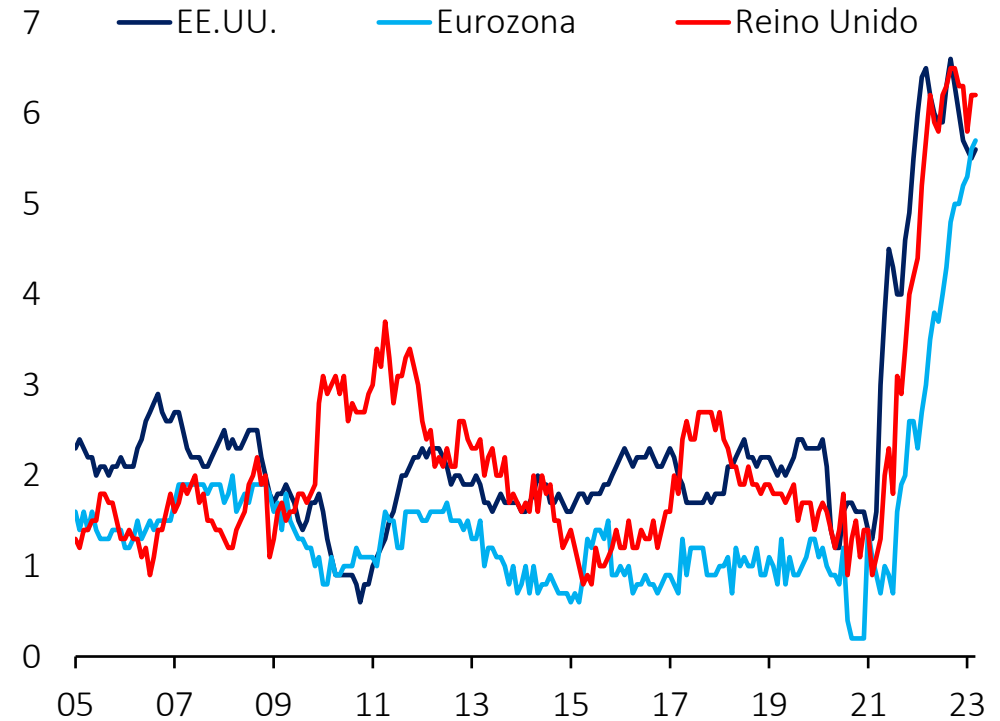
## Inflation in developed economies (\*)

(annual change, percent)

### Headline



### Core



Source: Bloomberg.

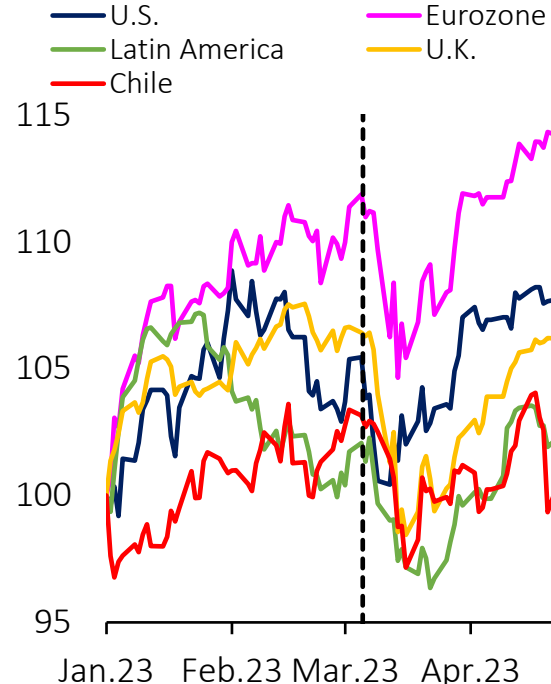
# Doubts about the financial health of global banks have dominated developments in the external scenario in recent weeks, with volatility spiking.



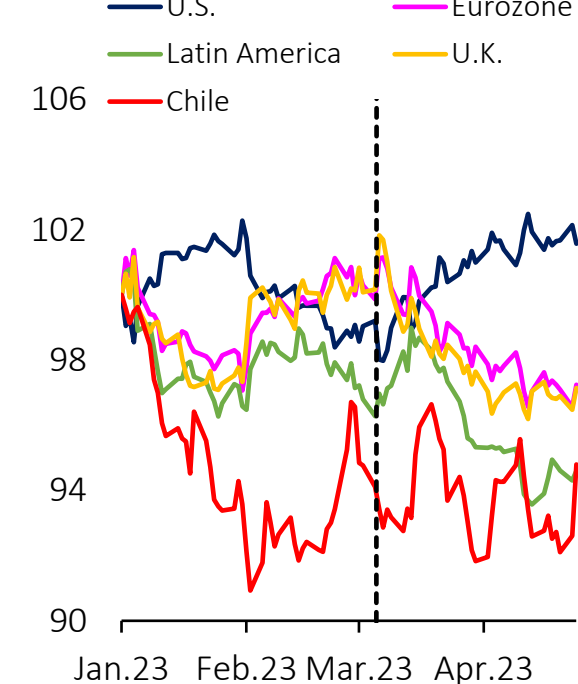
MOVE Index (1)(2)  
(index)



Stock markets (1)(3)  
(index, 2.Jan.23=100)



Currencies (1)(3)(4)  
(index, 2.Jan.23=100)



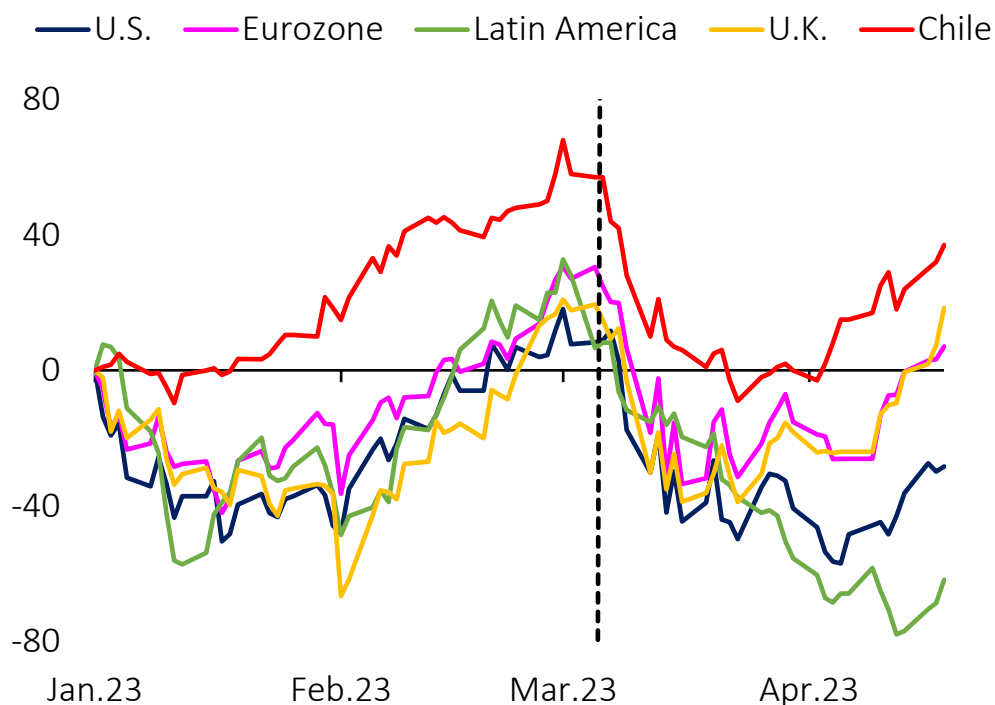
(1) Dotted vertical line marks 7 March 2023. (2) Measures the implied volatility of options on U.S. Treasury bonds with different one-month durations. (3) For Latin America, it uses the simple average for Brazil, Mexico, Colombia and Peru. (4) An increase (decrease) indicates a depreciation (appreciation) of the respective currency. Sources: Central Bank of Chile and Bloomberg.



Long-term interest rates have been undoing the increases observed until early March in view of the possible economic effects of a more complex financial situation.

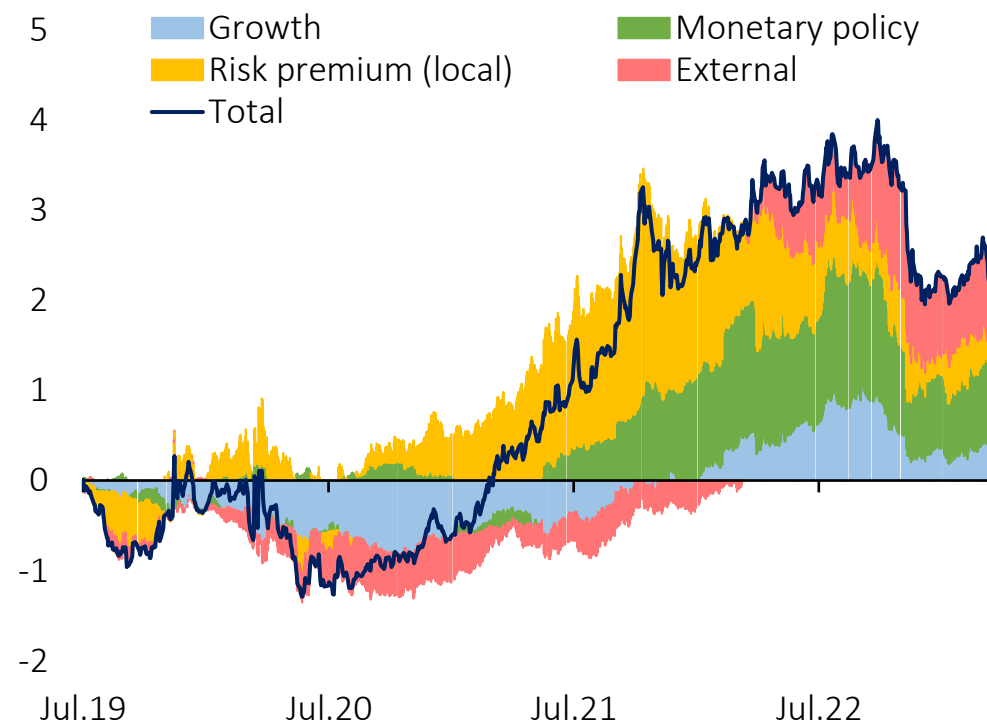
### Nominal 10-year rates (1)(2)

(diff. w/respect to 2.Jan.23, basis points)



### Structural decomposition of 10-year zero rate (3)

(basis points, accumulated since 1.Jul.2019)



(1) Dotted vertical line marks 7 March 2023. (2) For Latin America, it uses simple average for Brazil, Mexico, Colombia and Peru. (3) Historical decomposition of the long rate from a BVAR based on the identification strategy proposed by [Eterovic and Eterovic \(2022\)](#), incorporating an external block. The exogenous block encompasses all U.S. shocks (i.e., monetary policy, economic growth, risk aversion and pure risk), which have been aggregated for simplicity.

Sources: Central Bank of Chile and Bloomberg.

# The Chilean banking system is subject to a solid regulation and supervision oriented to prevent the occurrence of episodes like those that triggered the current uncertainty.



The dominant banking business model in Chile is traditional in nature. It is focused on granting credit on a more diversified basis of financing and adequate management of term mismatches.



The regulatory framework has been updated and considers Basel III capital and liquidity standards for all banks.



Every bank is subject to comprehensive annual supervisory processes for risk management, capital adequacy, liquidity and transparency.



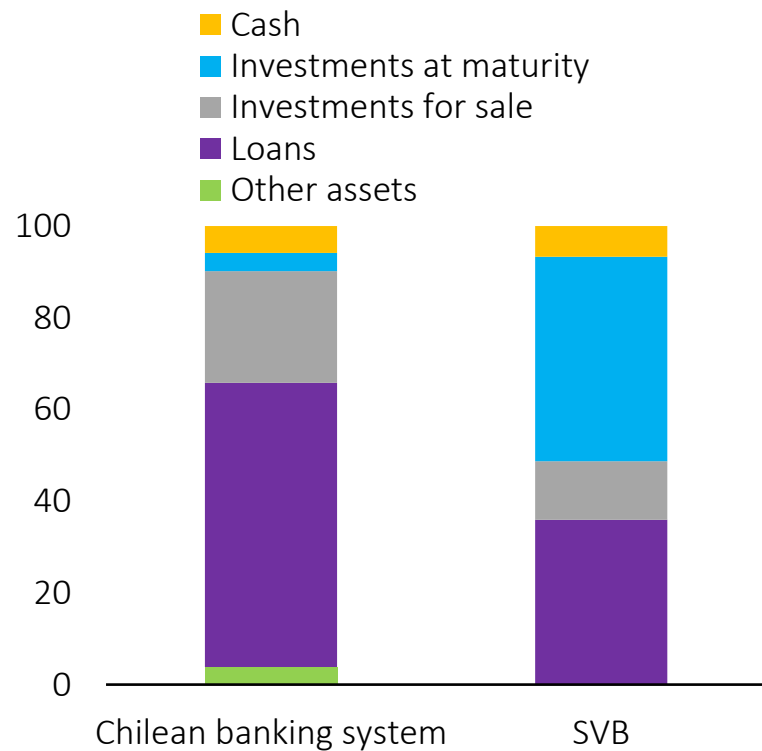
Both the Central Bank and the Commission for the Financial Market (CMF) monitor on a permanent basis the banks' capacity to withstand adverse events by conducting stress tests.



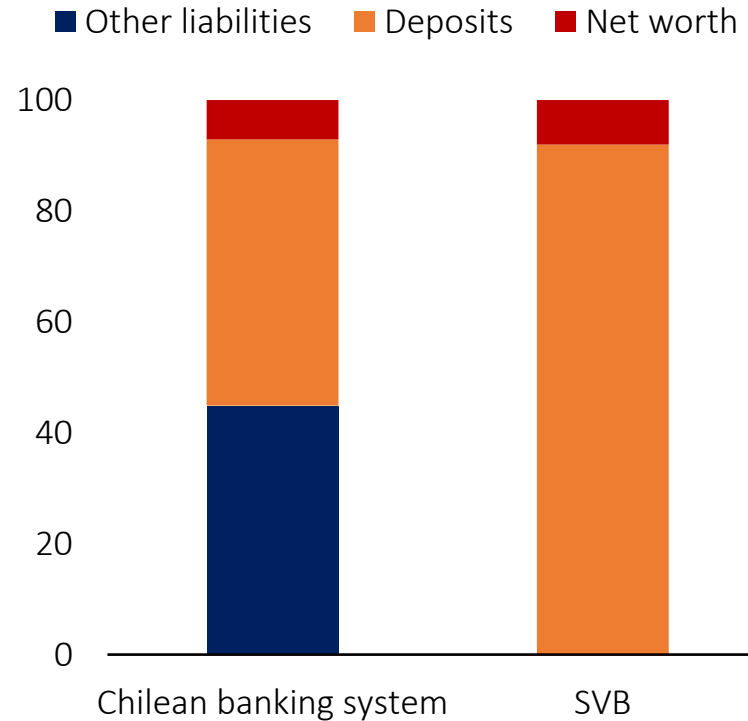
In addition, local banks operate in a traditional model. It is focused on granting credit on a diversified financing basis and adequate mismatch management.



Asset composition (\*)  
(percent of total assets)



Liability composition  
(percent of total liabilities)



(\*) Assets in Chile's banking system (CMF)

Cash: cash and bank deposits

Investments at maturity: debt instruments at amortized cost

Investments for sale: debt instruments at reasonable value and derivative instruments

Loans: commercial credits, lending to persons (consumer and housing), owed by banks

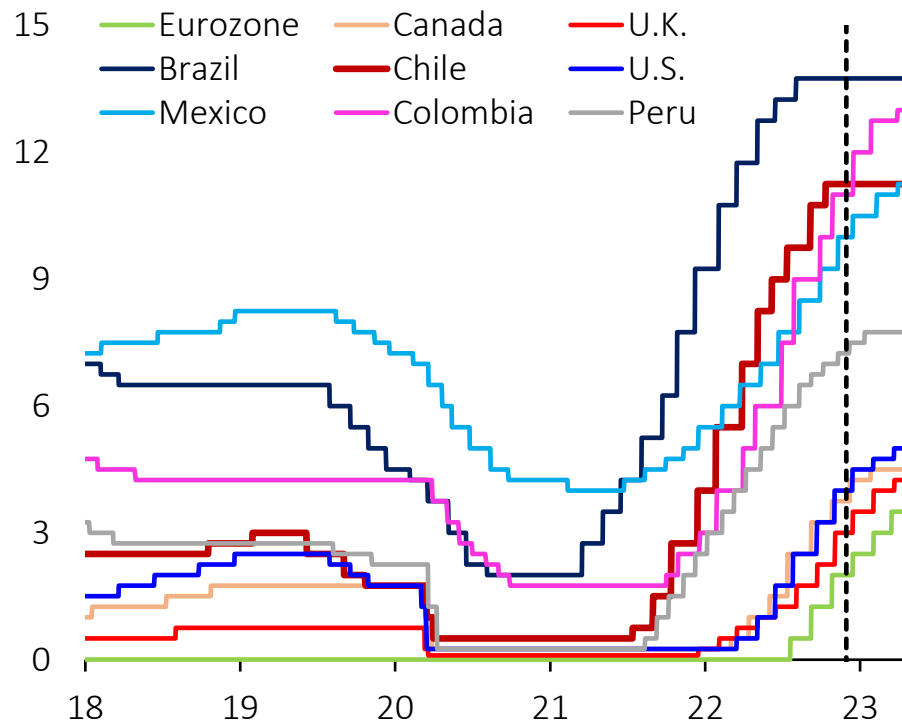
Other assets: deposits at BCCh, rights under agreements (repo and securities lending), intangible assets, fixed assets and others.

Sources: Commission for the Financial Market (CMF) and U.S. Securities and Exchange Commission (SEC).

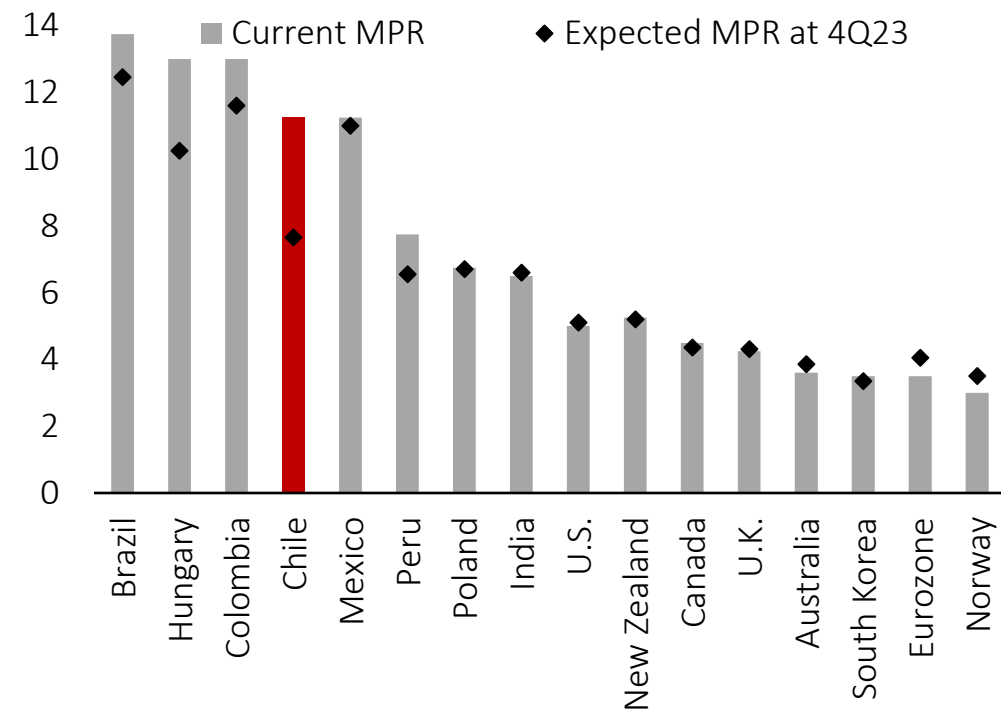
Importantly in this context, Chile made an earlier and significant adjustment to its monetary policy.



Monetary policy interest rates (\*)  
(percentage points)



Global MPRs and expectations  
(percentage points)



(\*) Dotted vertical line marks statistical cut-off of December 2022 MP Report.  
Source: Bloomberg.



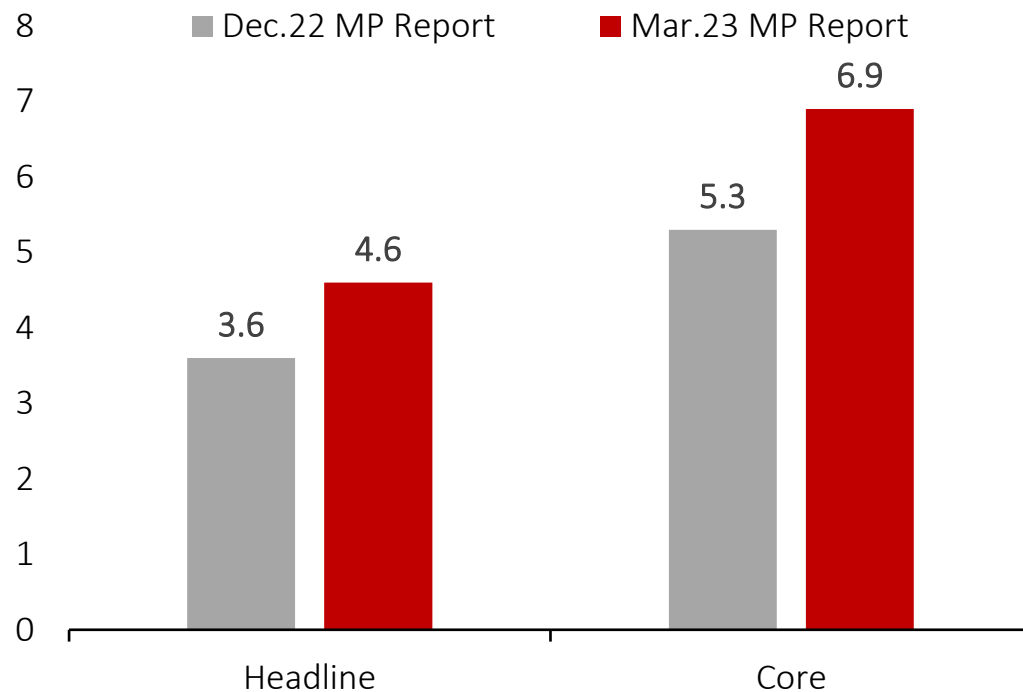
# Projections

# Our forecast for inflation by the end of this year increase with respect to the December MP Report.



## Inflation forecast at December 2023

(annual change, percent)



Source: Central Bank of Chile.

### This correction considers:

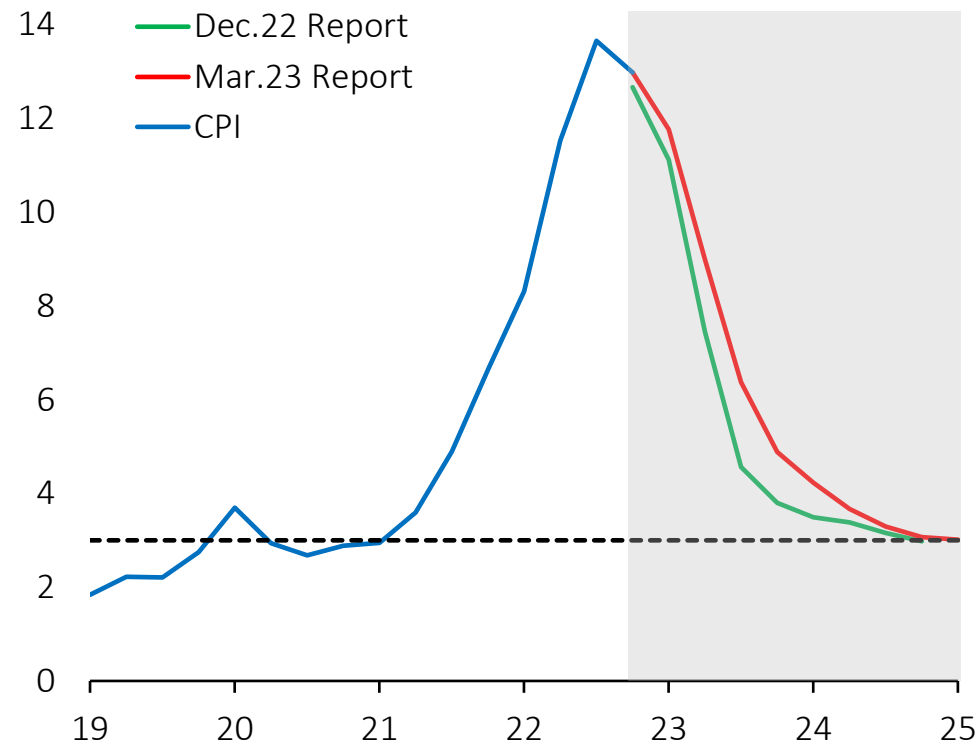
- A higher starting point, especially from the higher actual figures of core CPI.
- Slower than expected adjustment of local spending, especially in private consumption, which assumes longer-lasting demand pressures.
- Activity gap closing later than expected, in line with the slower adjustment of the economy.

In the central scenario, headline inflation will reach the 3% target in the latter part of 2024, while core inflation will do so by the end of the projection horizon.



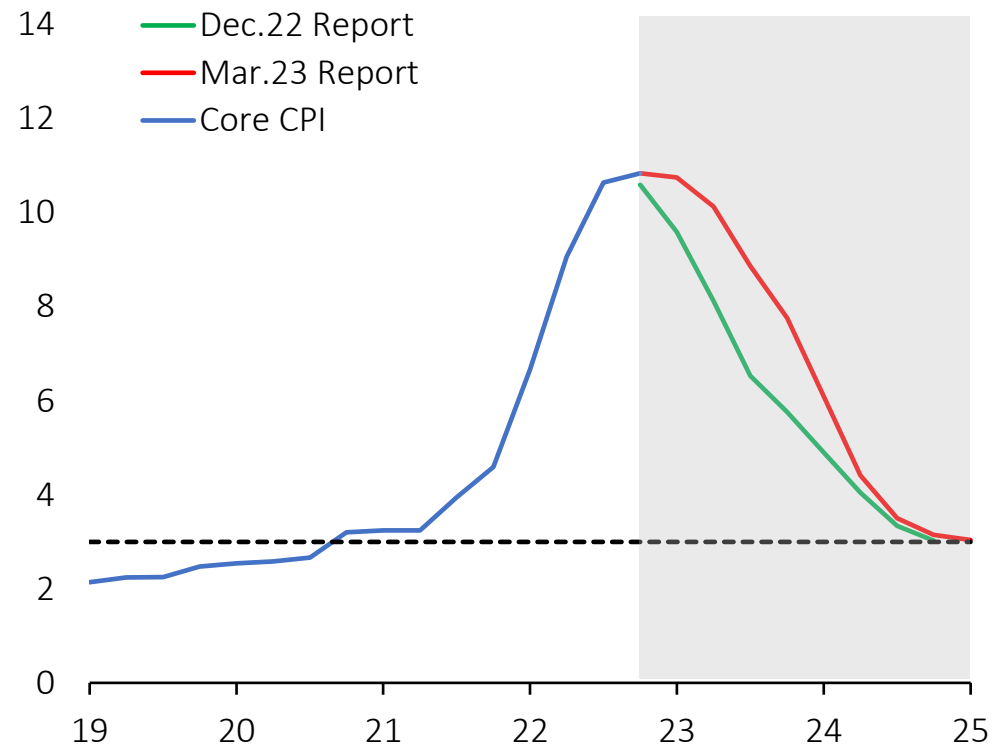
### Total CPI inflation forecast (\*)

(annual change, percent)



### Core CPI inflation forecast (w/o volatiles) (\*)

(annual change, percent)

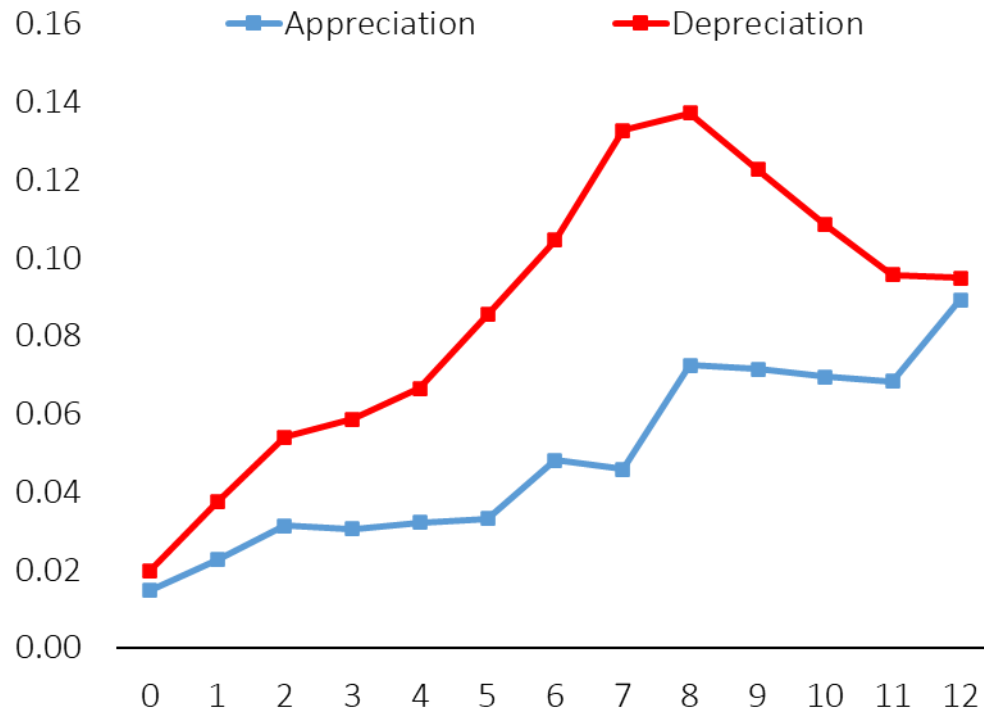


(\*) Figures as from first quarter of 2023 show forecast.  
Sources: Central Bank of Chile and National Statistics Institute.

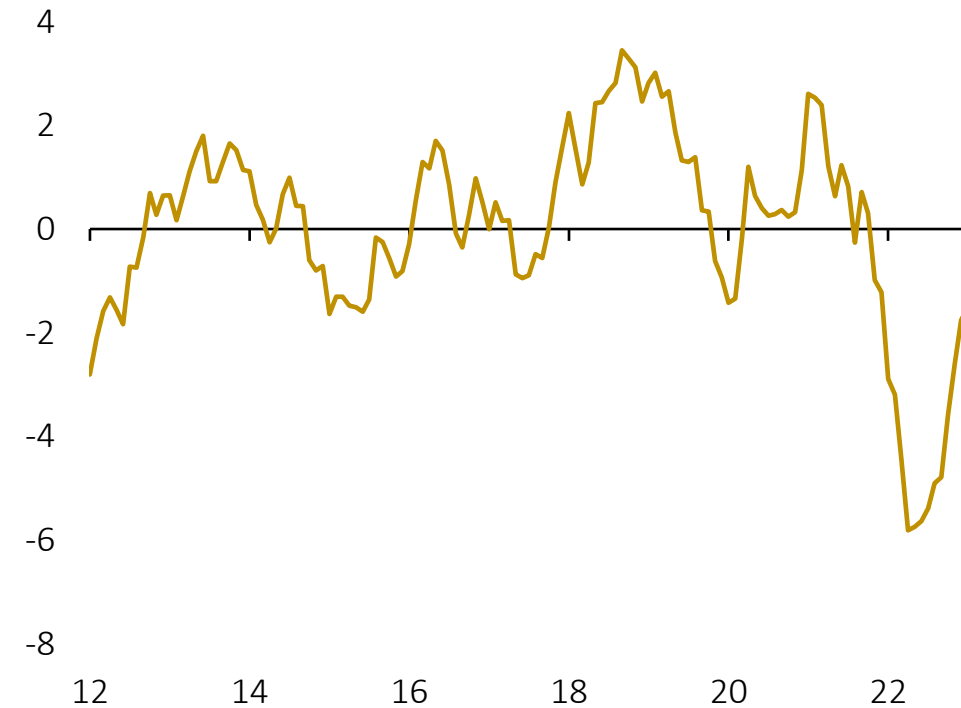
This inflation trajectory incorporates that the real exchange rate will, on average, be lower than estimated in December throughout the projection horizon. But consistent with evidence, it assumes that the pass-through to prices will be slower than in the case of depreciations.



Estimates of exchange-rate pass-through coefficient based on micro-data  
(percent change in prices of +/-1% ER)



Cyclical component of aggregate margins  
(moving three-month average, percent)



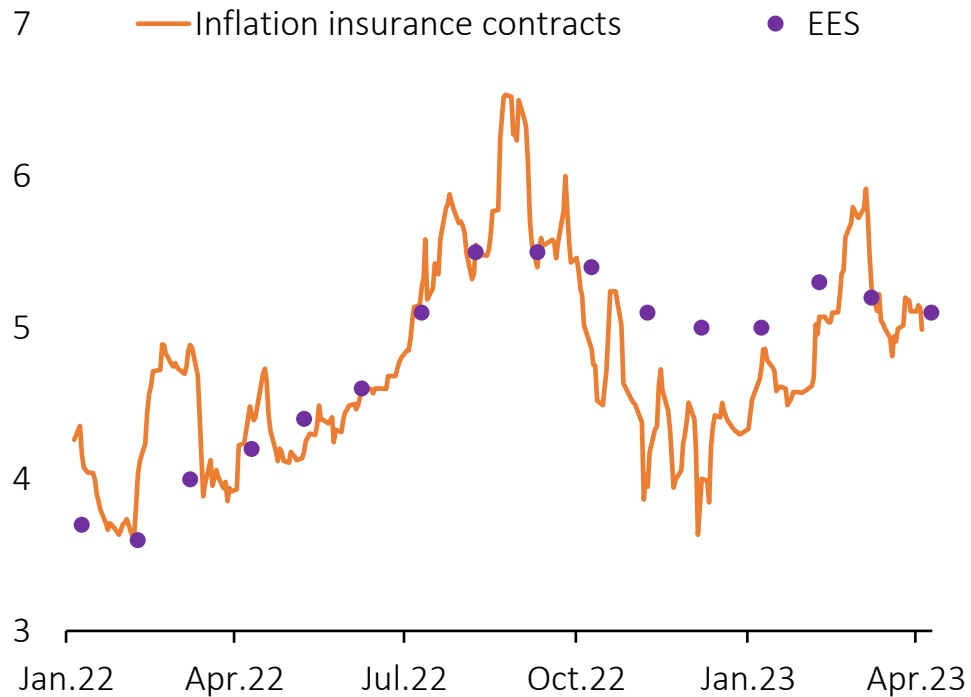
Sources: Arenas *et al.* (2023) and Acevedo *et al.* (2023)

Some measures for two-year inflation expectations remain above 3% and shorter-term ones exceed the December estimates.

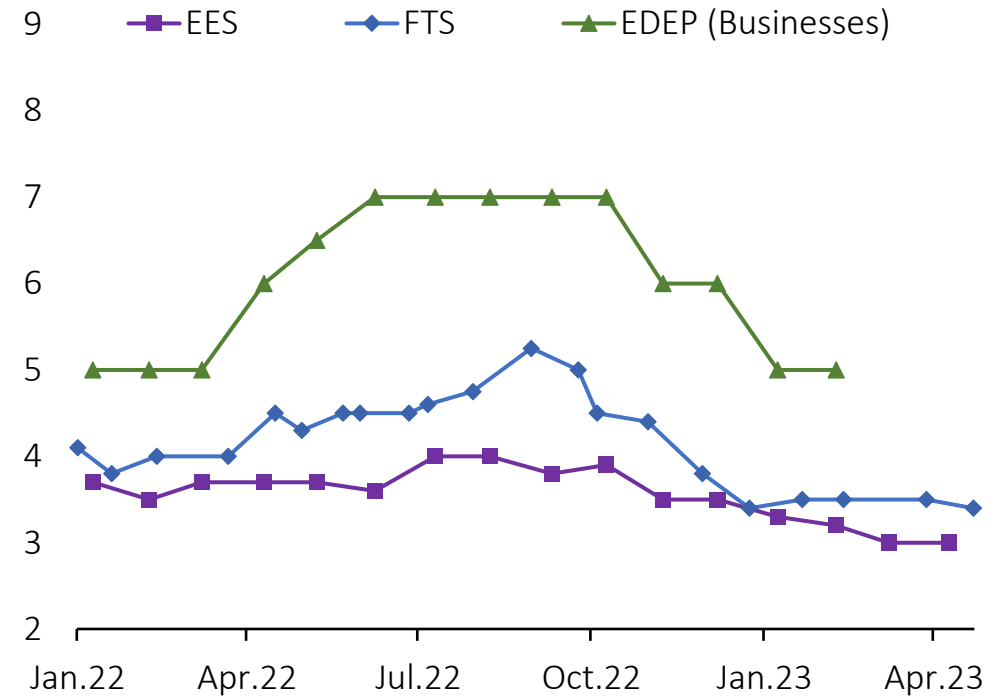


## Inflation expectations (annual change, percent)

### a) At December 2023



### b) Two years ahead



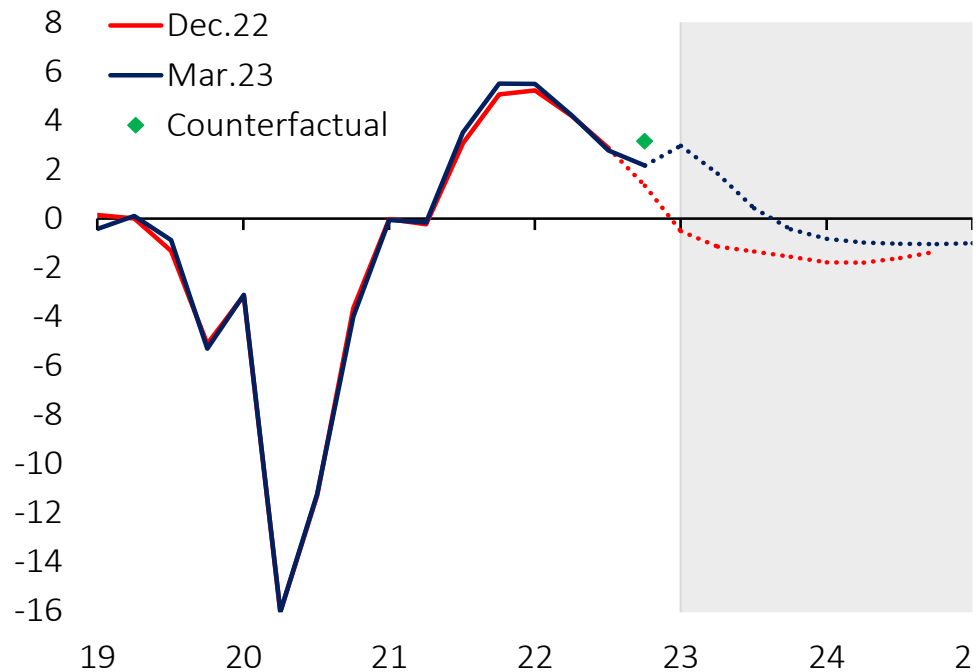
Sources: Central Bank of Chile and Tradition Chile.



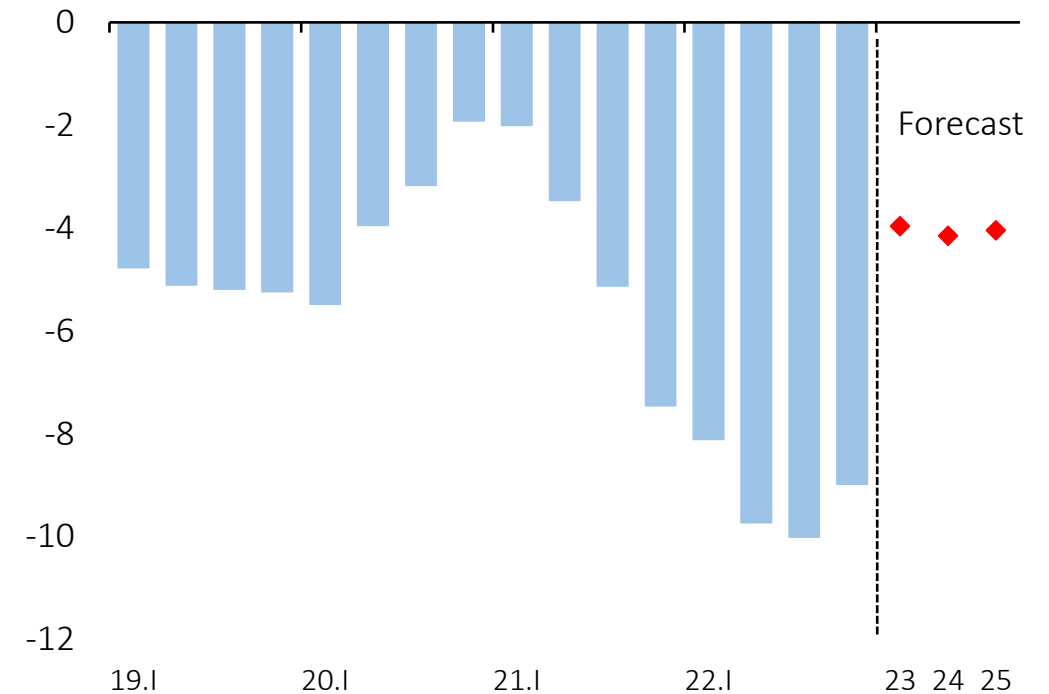
After the excessive spending of previous years, the adjustment of the local economy is still a key assumption behind the convergence of inflation.



Activity gap (1) (2) (3)  
(level, percentage points)



Current account (4)  
(percent of GDP, last twelve months)



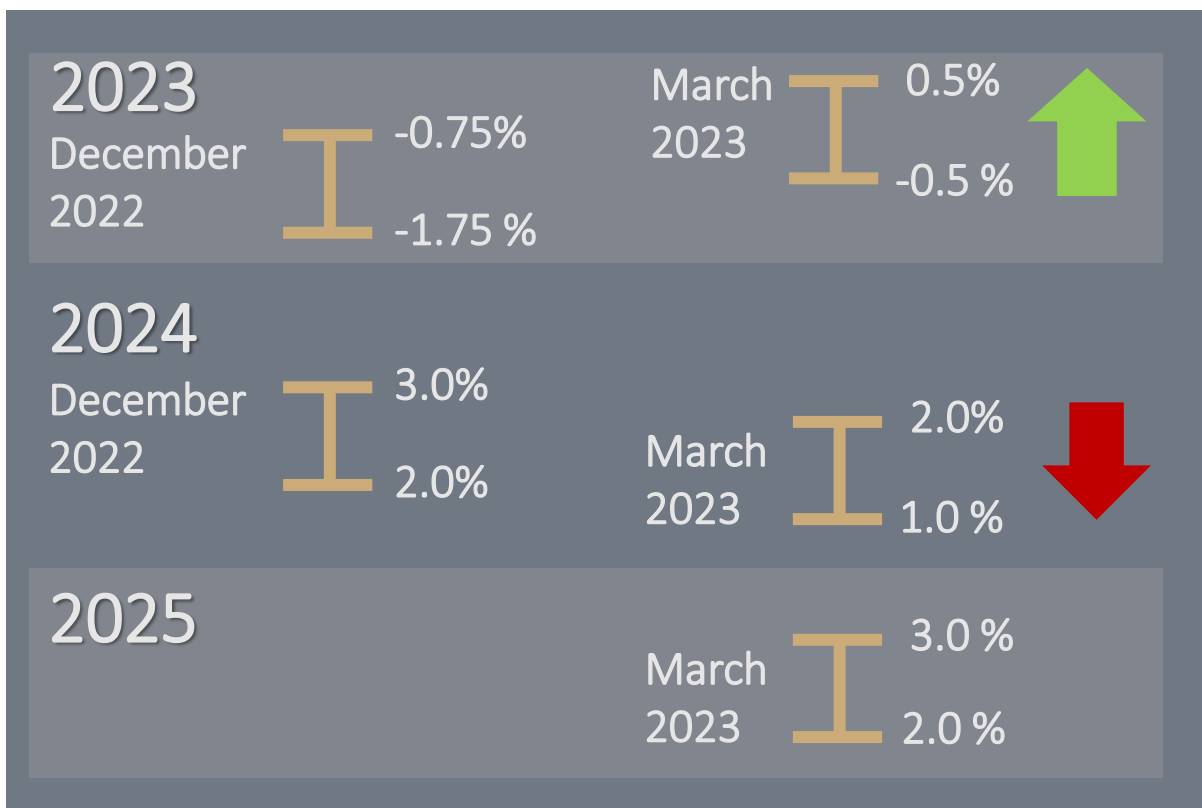
(1) Constructed using seasonally adjusted data. Dotted lines show forecasts. (2) Projection uses structural parameters updated in the December 2022 MP Report (trend) with methodological revision of potential GDP. (3) Counterfactual for 2022.Q4 estimated assuming that the value added measure of the Transport sector remains at its level of 2022.Q3, which is equivalent to zero velocity. All other non-mining sectors use published velocities. For the fourth quarter, both the effective and counterfactual gaps are calculated using the same potential GDP. (4) Quarterly effective data. Red diamonds show forecasts for respective years. Source: Central Bank of Chile.

Projections consider that activity will drop in the coming quarters and will accumulate growth around 1.5% between 2023 and 2024, similar to what was foreseen in the last MP Report.



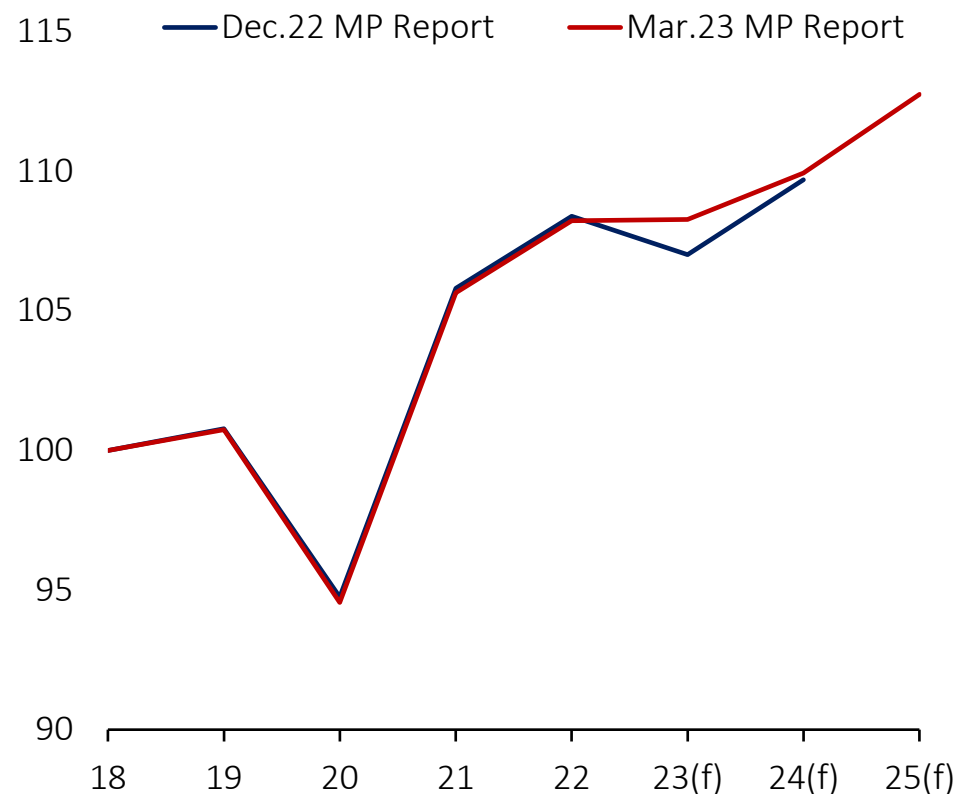
### GDP growth forecasts (1)

(annual change, percent)



### GDP forecasts (2)

(index, 2018=100)



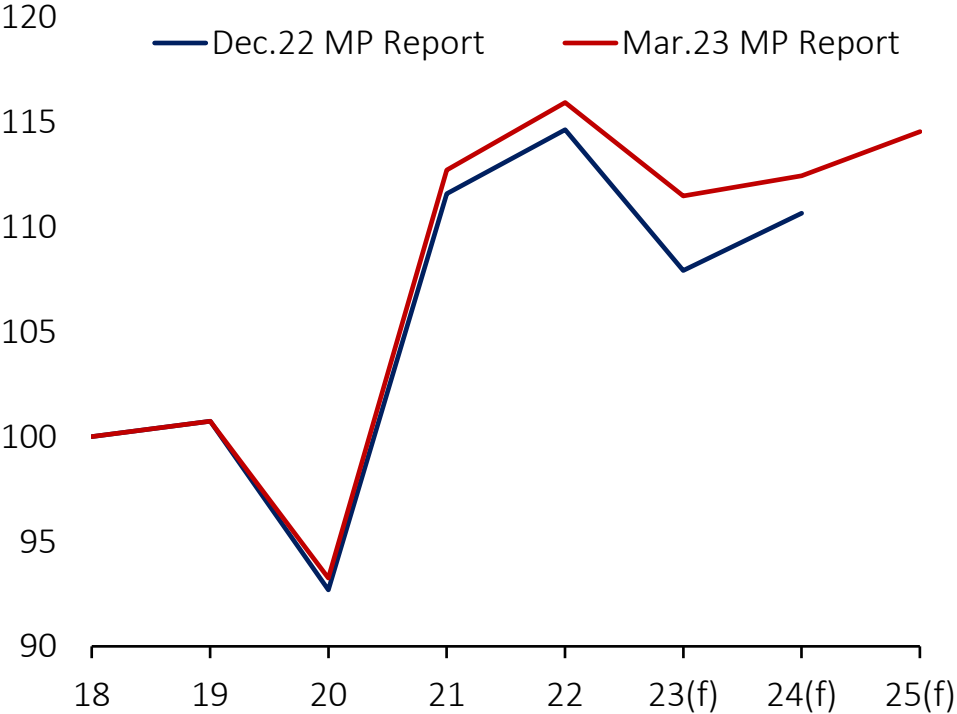
(1) Forecasts contained in respective MP Report. Arrows indicate change from December 2022 forecast. (2) Forecasts consider the midpoint of the growth ranges published in March Report. (f) Forecast.

Source: Central Bank of Chile.

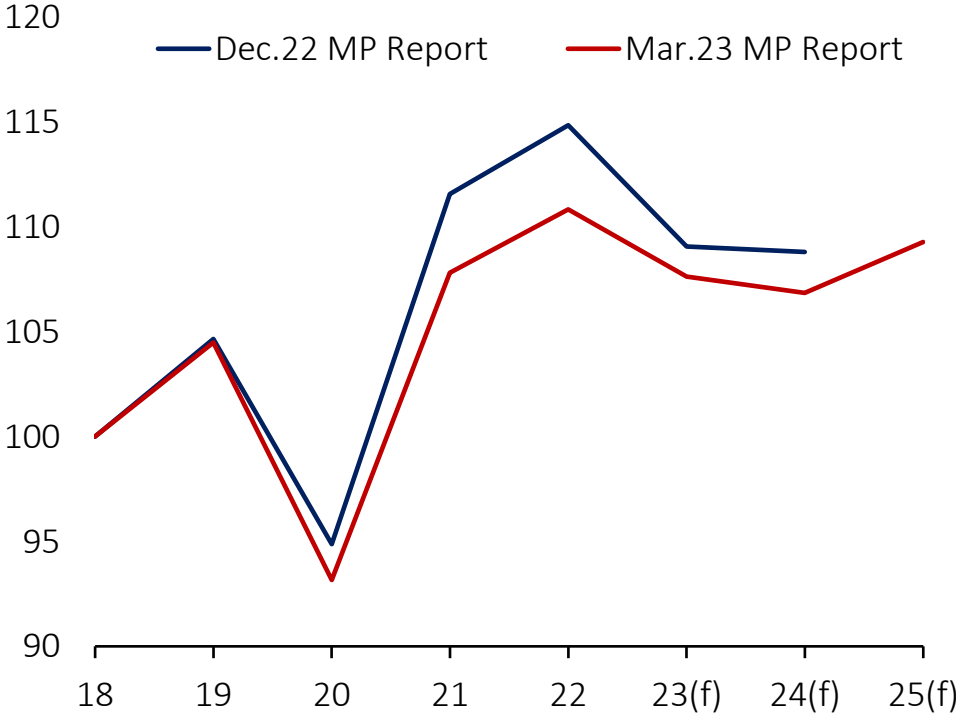
In the base scenario, the main components of domestic demand will decline this year, although less than expected in December, transferring a lower dynamism relative to what was previously projected in 2024.



Private consumption  
(index, 2018=100)



Gross fixed capital formation (GFCF)  
(index, 2018=100)

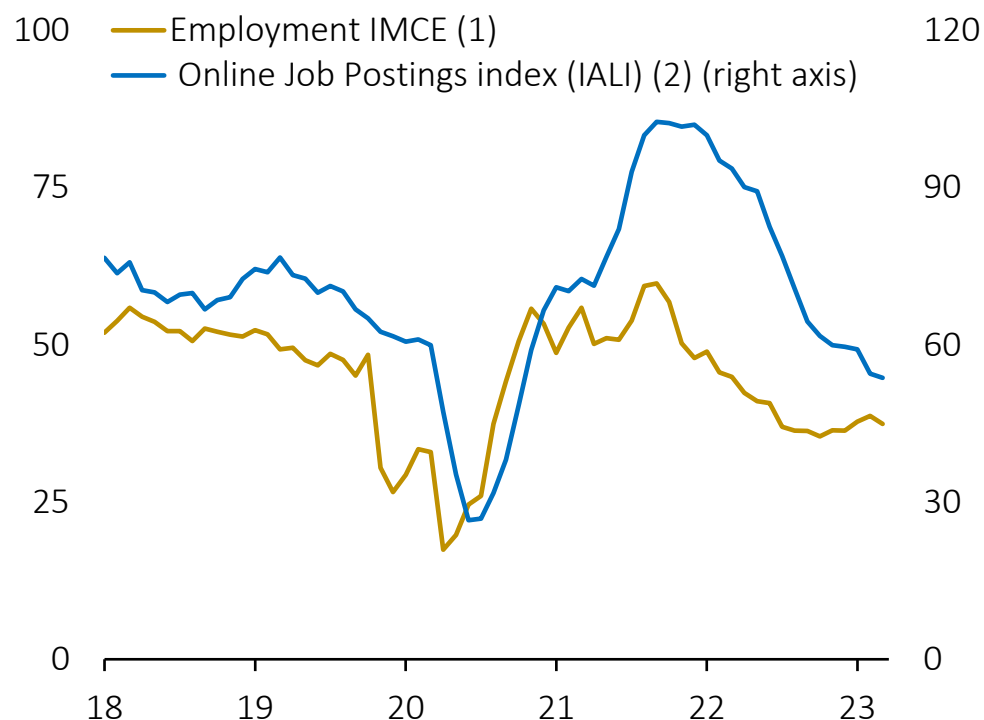


(f) Forecast.  
Sources: Central Bank of Chile and Consensus Forecasts.

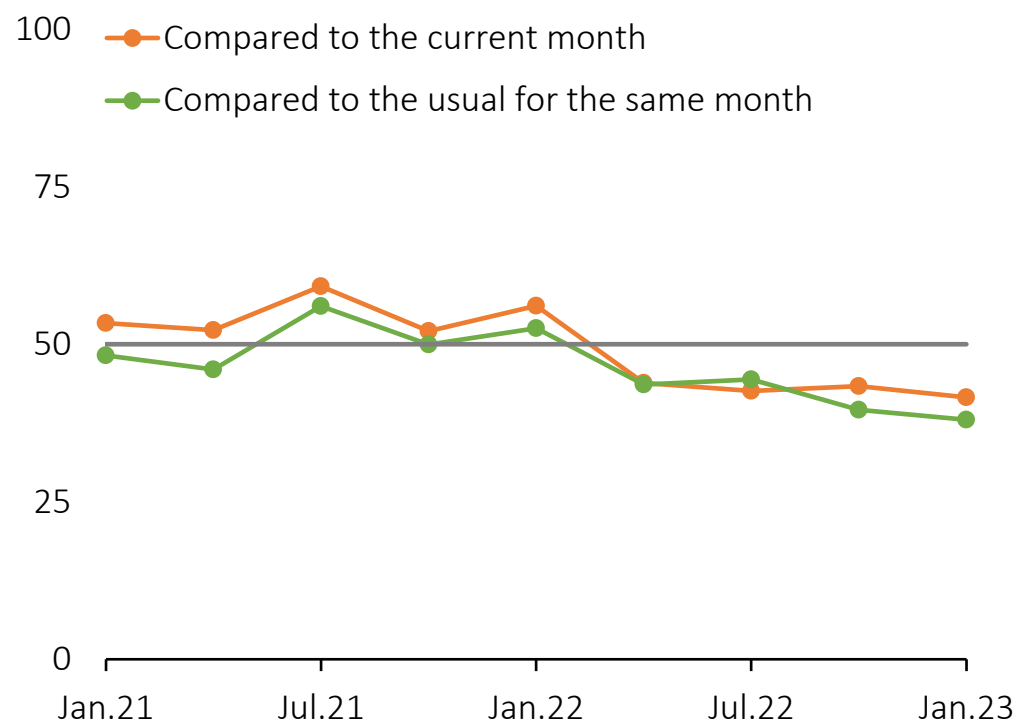
# Expected labor market dynamics are consistent with the expected performance of the economy.



Employment IMCE and Internet job postings index  
(index; index, Jan.2015=100)



Perception of expected staff one year ahead (3)  
(diffusion index)

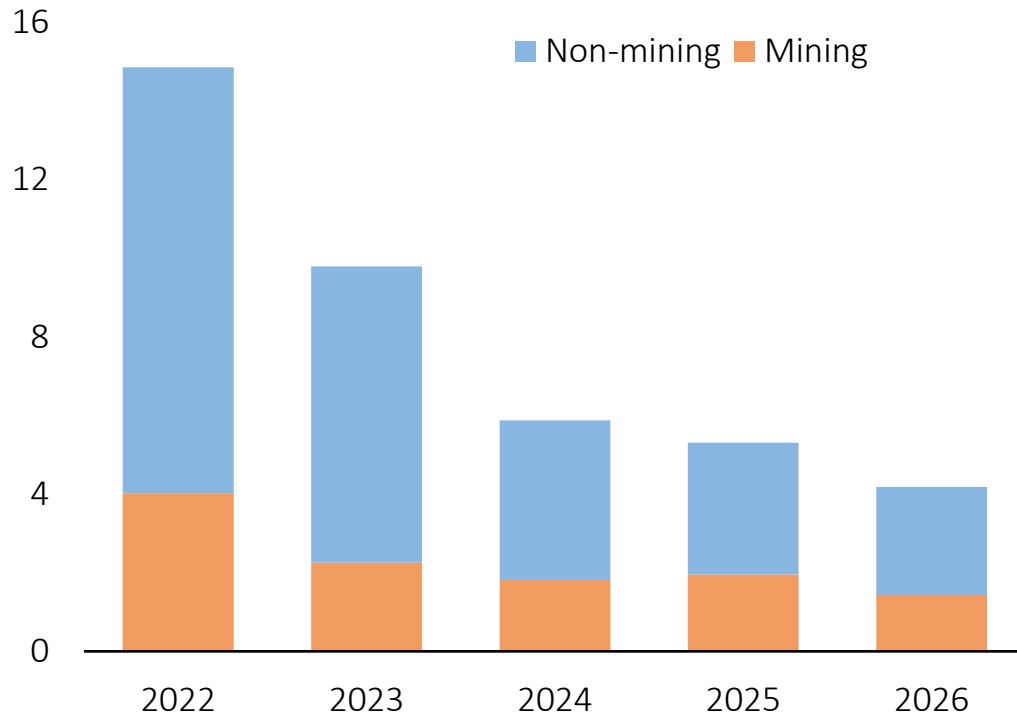


(1) Average of employment indicators in trade, industry and construction. A value below (above) 50 points reflects expectations of decreases (increases) in the number of workers in the next three months. (2) Three-month moving average. (3) Values above (below) 50 represent a higher proportion of increase (decrease) responses. The weighting by size incorporates the economic importance of the companies in the index, giving greater weight to the responses of companies with a greater share of value added. Sources: Icare/Universidad Adolfo Ibáñez and Central Bank of Chile.

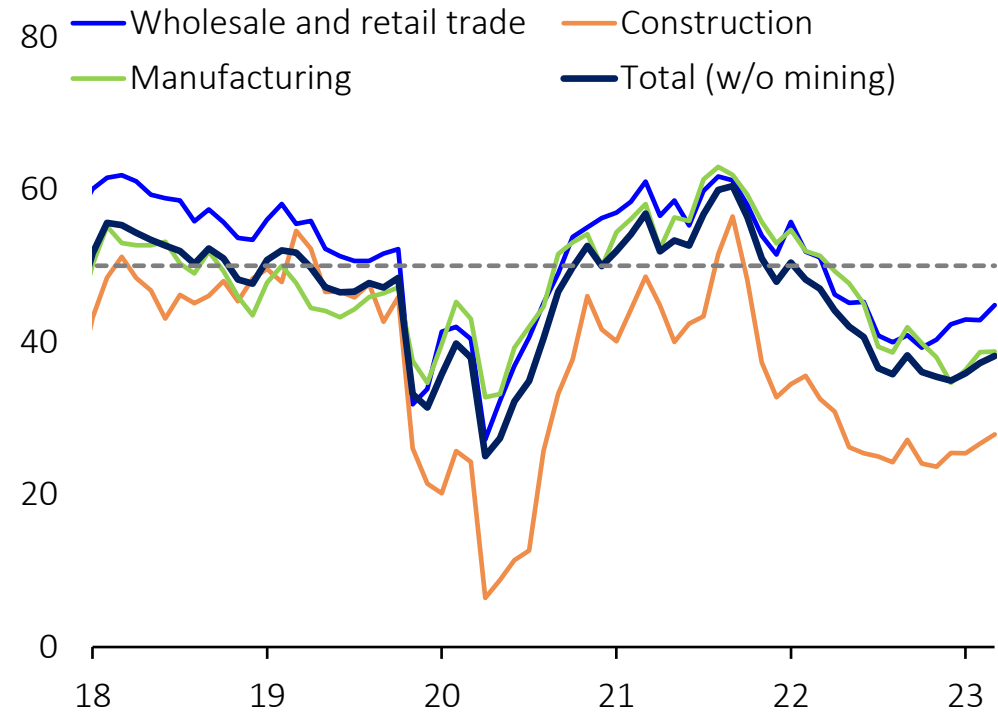
Additionally, investment project surveys and business expectations suggests a weaker performance of this part of spending in the future.



Investment amounts CBC 2023.Q1  
(billions of dollars)



Business expectations (IMCE) (\*)  
(index)

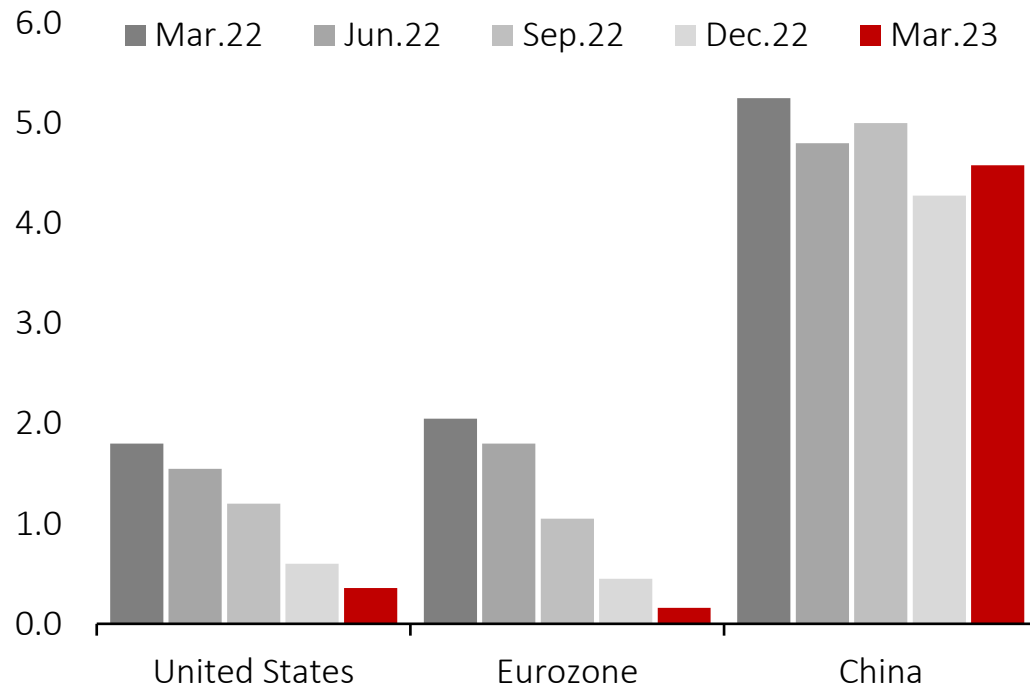


(\*) Value above (below) 50 indicates optimism (pessimism).  
Sources: Capital Goods Corporation (CBC) and ICARE/Universidad Adolfo Ibáñez.

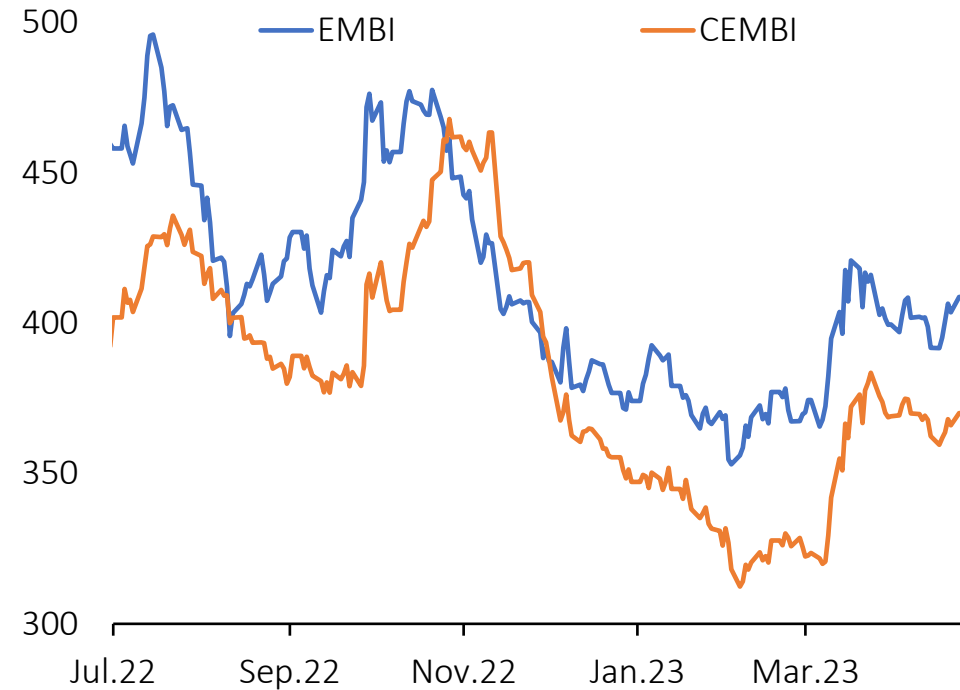
In both cases, a common factor behind the contraction expected for this year is the impact of a more deteriorated economic and financial external scenario. Nonetheless, for China, the boost from the lifting of sanitary restrictions is expected to dominate.



World growth forecasts for 2023-2024 (\*)  
(annual change, percent)



Global risk premiums  
(basis points)



(\*) Average of both years.

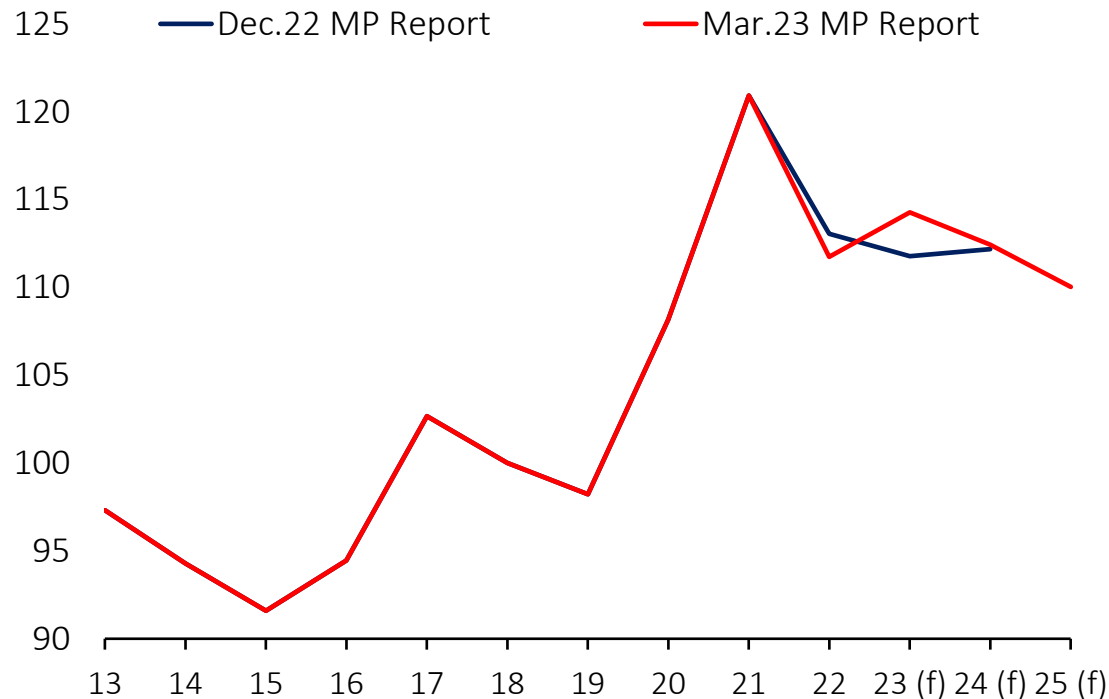
Sources: Central Bank of Chile and Bloomberg.

This drives the outlook for copper prices and terms of trade upward. Other commodity prices are revised downward.



### Terms of trade

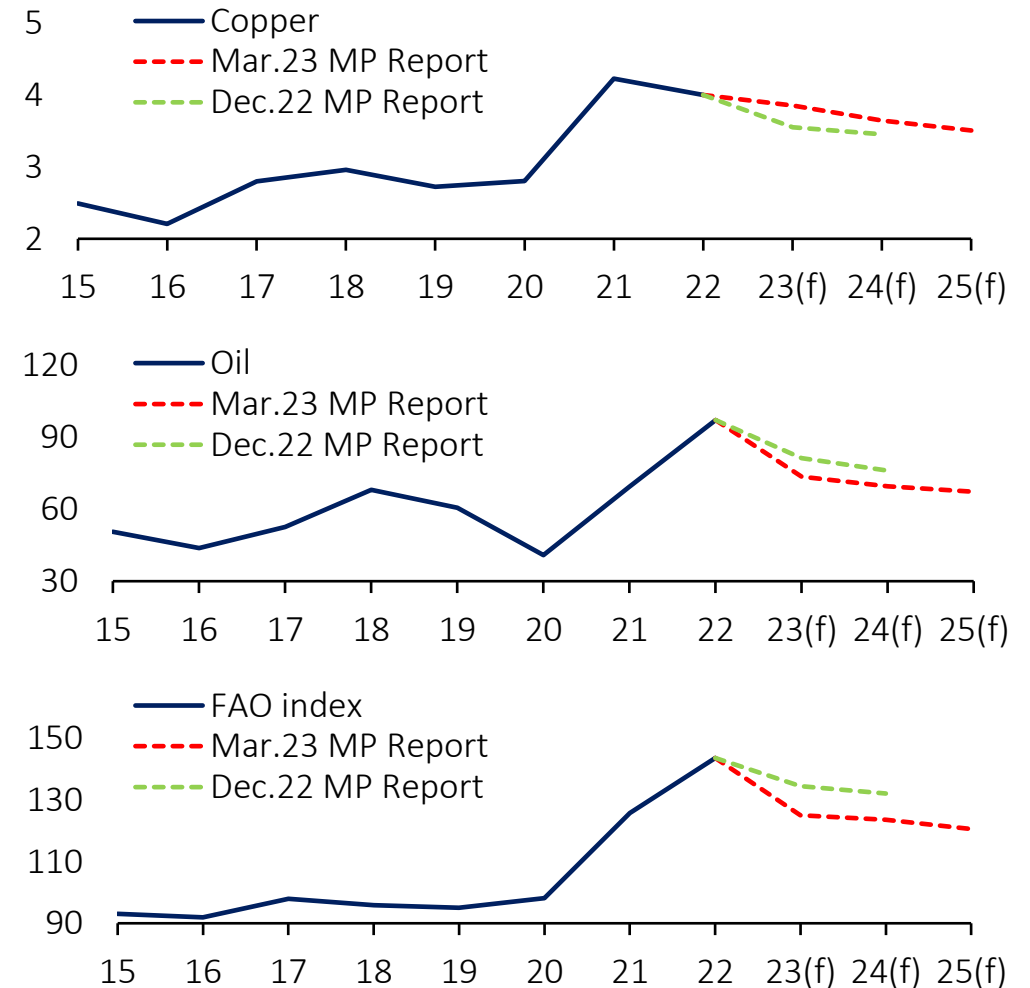
(level, 2018=100)



(f) Forecast. (1) For oil it is the average price between the WTI and Brent barrels. For foods is the FAO index. (2) Effective price/index is average for each year. Dotted lines represent the 2023-2025 projections contained in respective MP Report. Sources: Central Bank of Chile, Bloomberg and FAO.

### Actual and projected prices (1) (2)

(dollars per pound; dollars per barrel; index)



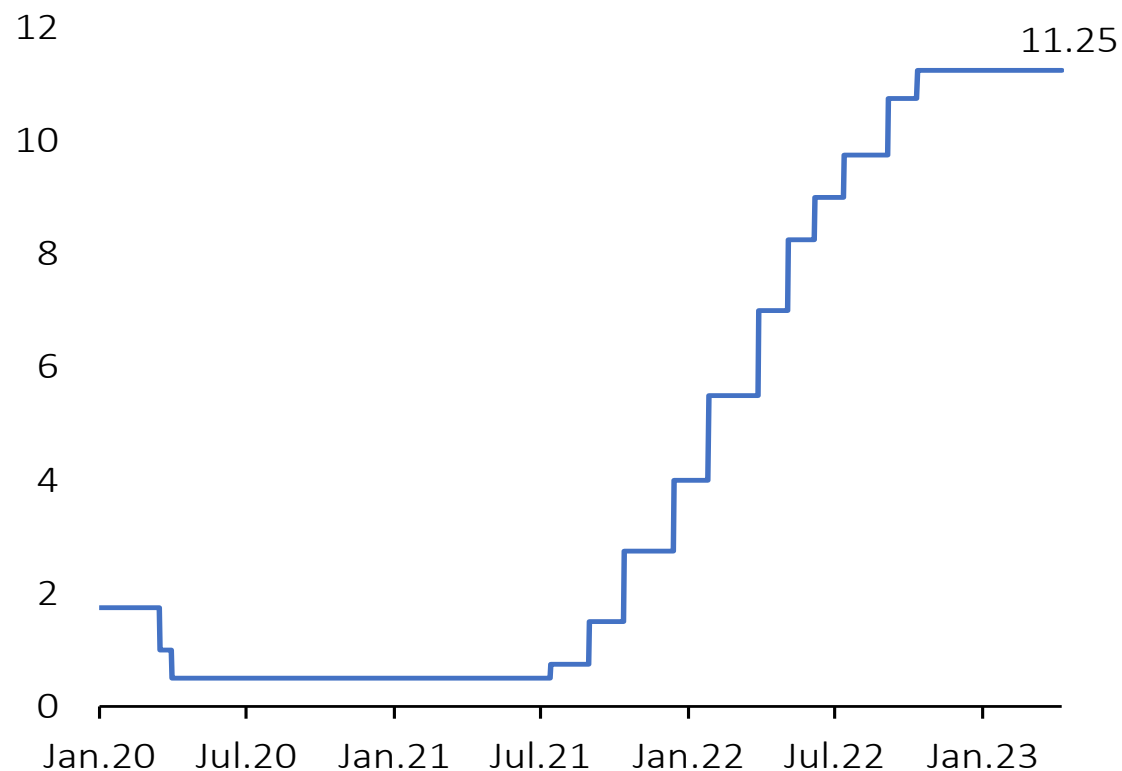


The Board considers that it will be necessary to keep the MPR at 11.25% until macroeconomic conditions indicate that the process of inflation convergence to the 3% target has been consolidated. As described in the central scenario of the March MP Report, this process will take longer than expected in December.



## Monetary policy interest rate (MPR)

(percent)



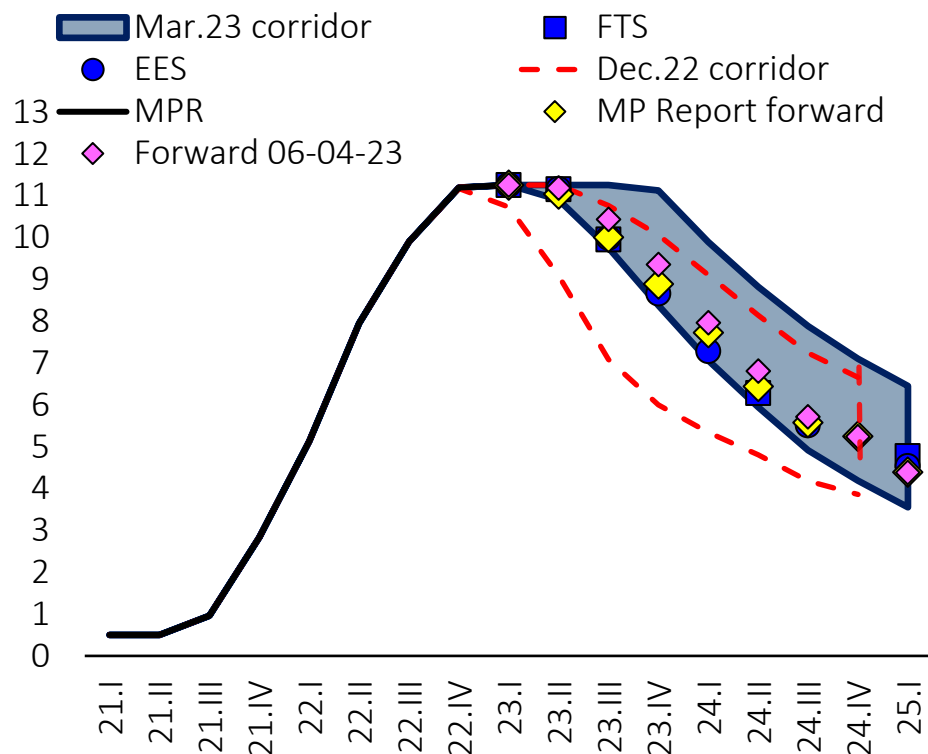
Source: Central Bank of Chile.

- The economy is adjusting more slowly than expected and inflation is taking longer to come down.
- In this context, the Board considers that it will be necessary to keep the MPR at 11.25% until macroeconomic conditions indicate that the process of inflation convergence to the 3% target has been consolidated.
- As described in the central scenario of the March MP Report, this process will take longer than expected in December.
- The Board reaffirms its commitment to act with flexibility in case any of the internal or external risks materializes and macroeconomic conditions so require.

The borders of the MPR corridor reflect scenarios where the pace at which inflation will return to the target is somewhat different, which would lead to earlier or later interest rate adjustments than those considered in the central scenario.



MPR corridor (\*)  
(quarterly average, percent)



**Inflation persistence:** particularly significant will be the occurrence and sign of new inflation surprises, the evolution of consumption and the unfolding of external conditions.

➔ Depending on how these variables behave, this could lead to a sooner- or later-than-expected reduction in the MPR.

**Upper bound:** MPR is kept at its current level for longer than anticipated in the central scenario.

- ➔ High inflation is prolonged
- ➔ Slow adjustment of consumption
- ➔ Better than projected external scenario

**Lower bound:** Faster adjustment of the local economy and earlier reduction of inflation and the MPR.

- ➔ Worse than expected external scenario
- ➔ Higher global risk
- ➔ Strong impact on global activity and commodity prices

(\*) The corridor is constructed following the methodology of [box V.1 of the March 2020 MP Report](#) and [box V.3 of the March 2022 MP Report](#). For details, see methodological note (figure II.1, chapter II, March 2023 Monetary Policy Report). Source: Central Bank of Chile.

There are also risk scenarios that could drive growth outside the projection range and would require a policy response that would exceed the corridor limits of the MPR corridor.



## Risk scenarios



The evolution of the external scenario needs to be constantly monitored.

- In a scenario of significant disruption of global financial conditions, a major deterioration of the global and local economies is expected, with strong impacts on the medium-term inflationary trajectory.
- This would lead to even faster MPR reductions than those marked by the lower bound of the MPR corridor.

Besides, the inflationary problem has not been resolved.

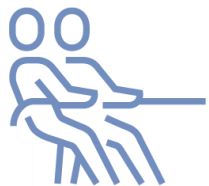
- The inflation convergence has not been consolidated. Inflation remains very high, with a core component that has shown no decline in the past few months.
- The adjustment of private spending has been slower than expected.
- Some measures of inflation expectations remain above 3% in the two-year term.
- A scenario where private consumption resumes stronger growth rates would compromise the convergence of inflation to the target and could require further increases in the MPR.

# Conclusions



Inflation has remained high for a long period of time. The high core component has surprised to the upside in recent months and is close to the peaks of 2022. The persistence of high inflation is the result of multiple shocks of different nature, whose magnitude and combination have exacerbated their impact.

A very important element behind this stubborn inflation is that the economy's adjustment process has not yet succeeded in reducing the effects of excessive spending of previous years. In fact, the economy continues on an adjustment path that began last year but that it has been slower than anticipated. In particular, the reduction in household consumption has been slow, which has important implications for inflationary dynamics.



Reducing inflation is an unavoidable condition for sustainable improvement in economic performance and for the economy to be able to cope in the best possible way with the impact of external shocks. It is particularly important for all policies to point in the same direction, which requires avoiding policies that boost private spending beyond its possibilities.

In this context, the Board considers that it will be necessary to keep the MPR at 11.25% until macroeconomic conditions indicate that the process of inflation convergence to the 3% target has been consolidated. As described in the central scenario of the March MP Report, this process will take longer than expected in December. The Board reaffirms its commitment to act with flexibility in case any of the internal or external risks materializes and macroeconomic conditions so require.





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