

“Chile: Recent Developments and Policy Challenges”
Remarks by Mario Marcel, Governor of the Central Bank of Chile
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Over the last year and a half, the Chilean economy has suffered three major shocks originating from non-economic factors—the social crisis of late 2019, the indirect impact of the global crisis caused by the Covid-19 pandemic, and the direct impact of the pandemic in Chile and the sanitary measures to control it. This has made the country accumulate 17 months operating in an economic emergency mode.

This particularly adverse scenario fostered an unprecedented response of economic policy, both in terms of its size, persistence, innovation, and coordination. This response was stronger than that of other emerging economies due to the policy space gained after many years of building up financial buffers in Chile as well as the effectiveness and credibility of its policy framework. In a way, institutional strength is also reflected in the health policy response to the pandemia, most notably in the massive vaccination process currently under way.

A timely policy response, as well as the adaptability of some sectors, allowed the Chilean economy to begin its recovery as soon as the evolution of the pandemic allowed so. Thus, after contracting 14% in the second quarter of 2020, the economy accumulated a 12% recovery in the following two quarters. Notwithstanding the depth of the initial economic contraction, the worst of the crisis is getting increasingly behind.

These overlapping crises have had a very important impact on the labor market due to their special impact on labor-intensive sectors, high labor force turnover, and the weakness of social protection systems. Women have been especially affected by the suspension of face-to-face classes in the educational system for a whole year, which has contributed to a setback of more than a decade in their labor participation rate.

The social and economic cost has been contained through extraordinary transfer programs to households as well as by guarantee programs to foster lending to SMEs. To this is added access to pension savings for households, through the withdrawal of pension funds. The latter mechanism, however, has longer-term implications on saving, investment, and income distribution.

In the case of credit, the combination of state guarantees, CBC liquidity and regulatory forbearance have contributed to foster a countercyclical response of corporate credit that expanded at double-digit rates during most of 2020. This contained the impact of the crisis on the solvency of many firms. Public policies have been specially oriented to SMEs, with no special measures or programs to support larger companies.

The impulse of economic policies should continue well into the recovery, given the heterogeneity of the impact of the crisis and the high degree of uncertainty that both Covid-19 and the social crisis have generated. The expansionary impulse of these policies may be sustained because, in the course of the crisis, policy space has been rebuilt, especially at the CBC level. The most recent measure in this regard is the program to replenish and expand international reserves announced last January.

A part of this greater policy space has also come from developments in the world economy. The favorable external financial conditions as a result of the expansionary policies of the large central banks stand out. More recently, the recovery of international trade and the increase in copper added to the above. Both factors are related to the unusual characteristics of the Covid-19 crisis and the policy responses of the world’s largest economies.

This, together with the advancement of the population vaccination program, has led to an improvement in the prospects for the Chilean economy in 2021 and 2022, where growth projections have corrected upwards for 2021. The latest projections from the CBC point to an annual growth of between 5.5% and 6.5% that year. Business and consumer expectations surveys also reveal a more positive outlook from economic agents.

Even so, the output gap will take time to close. After broadening well beyond recent experience, the gap is not expected to close before mid-2022. Until then, the pressures on inflation will be downward, which will require maintaining a highly expansionary monetary policy.

The former does not rule out episodes of inflationary volatility in the short run, which could occur as a result of supply restrictions, stock breaks, or exchange rate effects, among others. As long as these episodes are short lived and do not affect the determinants of inflation in the medium term, they should not alter the trajectory of monetary policy.

Recovery will be challenging in any case. There are many scars in the situation of companies and households that will take time to overcome, such as a larger debt burden, the increase in labor informality and higher perceptions of risk. There are more permanent changes in the organization of production, logistics, and work that will have to be addressed.

Public policies should remain largely expansionary but to adapt to the specific needs of the recovery. This calls for a transition from the broader, across-the-board approach adopted to contain the first impact of the crisis, to more focused measures, aimed at facilitating the adaptation of affected sectors on a more permanent basis. The experience of the 2008-09 *Global Financial Crisis* indicates that the exit of extraordinary measures of fiscal and monetary support will require careful management.

At least in the case of the CBC, the latter is favored by a clear definition of the objectives, expected results, and time horizon of several of the measures adopted. The CBC has also avoided intervening in credit allocation decisions, relying instead on market decisions, based on knowledge of clients by financial institutions.

The assessment of this difficult period in Chile reveals the value of the institutions and prudential policies applied in the past to face adverse scenarios. At the same time, they provide a deeper meaning to these institutions and policies, in the sense of facilitating exceptional responses in exceptional circumstances.

This will be an important element in the constitutional process that will take place from the middle of this year. More than a risk, this should be seen as an opportunity that other countries will not have, to update and strengthen the country's institutional framework, incorporating the experience and lessons learned from specific episodes of tension such as those that have been experienced in the last year and a half.
