

MONETARY POLICY REPORT

MARCH 2021

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Monetary Policy at the Central Bank of Chile



Money plays a fundamental role in the proper functioning of any 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 the population's well-being by safeguarding the purchasing power of their income and ensuring a more efficient functioning of the economy. When inflation is low and stable, monetary policy can also moderate fluctuations in employment and production.

The Central Bank of Chile conducts monetary policy guided by its objective of having projected inflation at 3% annually over a two-year horizon, irrespective of its current level. This is similar to the practice in other countries which, like Chile, have a floating exchange rate. This is known as an inflation-targeting scheme.

The Monetary Policy Rate (MPR) is the main instrument used by the Bank to achieve the inflation target. Its level is decided at the Monetary Policy Meeting, which is held eight times a year. In practice, the MPR is a reference interest rate for determining 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, through them, prices and inflation. Monetary policy decisions take several quarters to be fully reflected in the economy, which justifies monetary policy being made from a forward-looking perspective, with the primary focus on two-year inflation projections and not just today's inflation.

Since the Central Bank makes its monetary policy decisions autonomously, it must constantly give an account of them and their results to the general public. This is so not only as a state-run agency within a democracy, but also because a credible monetary policy, that is understood by the people, helps to keep inflation low and stable. Through the Monetary Policy Report (MP Rep.), the Bank communicates to the general public its views on the recent evolution of the economy, its outlook for the coming years and the way in which, in this context, it will manage monetary policy in order to meet the inflation target.



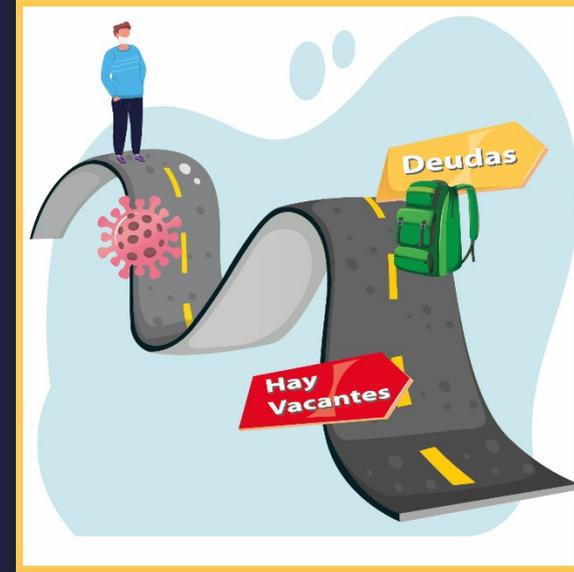
What does this MP Report tell us?



Chile's process of economic recovery has proceeded faster than expected. Successful adaptation of individuals and firms has played a key role.



Several economies, including China and the U.S, have also rebounded sooner than anticipated, which has helped sustain Chile's growth. Vaccinations are also progressing around the world.



Many risks persist, however, as magnitude of Covid-19 shock means that exiting episode will not be easy. Soaring infections and sanitary constraints are clear examples.



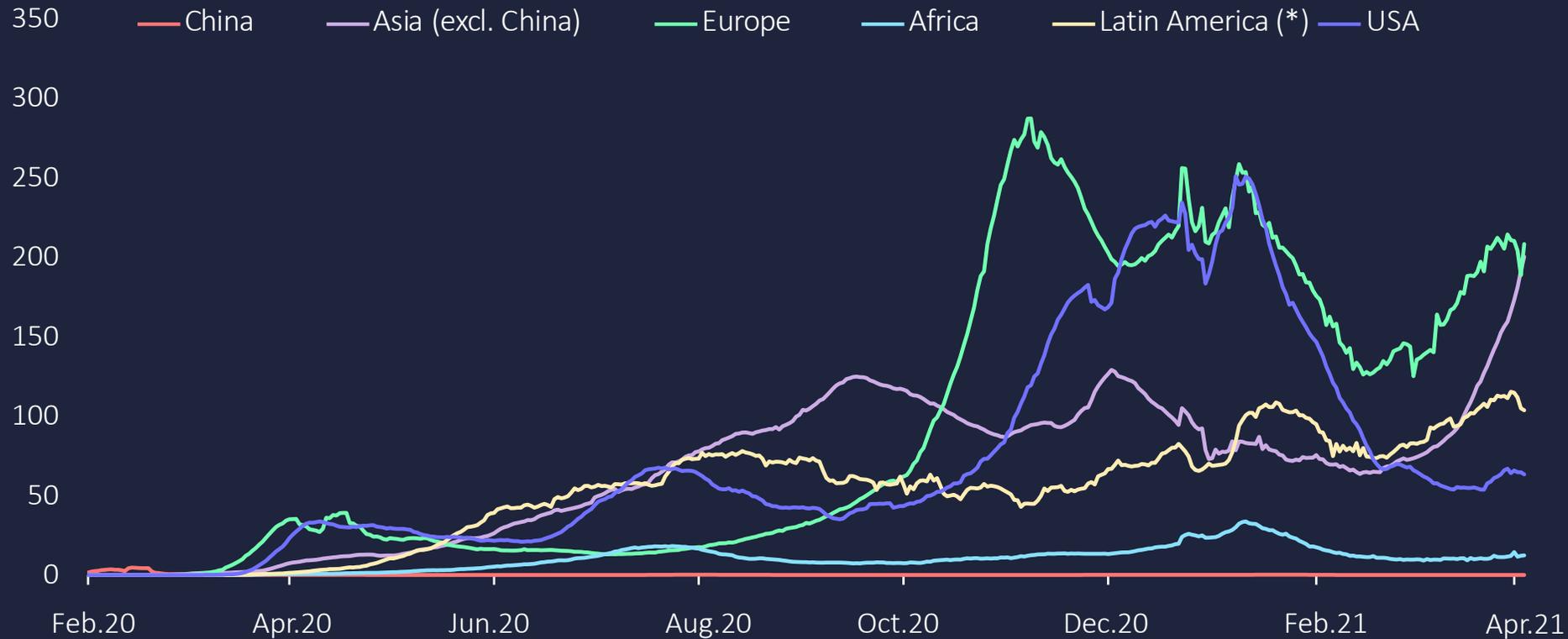
The Central Bank of Chile and other public institutions have made important efforts to deal with the crisis and will be key in ensuring the recovery.



Infection levels remain high in several countries.

New Covid-19 cases

('000, weekly moving average)



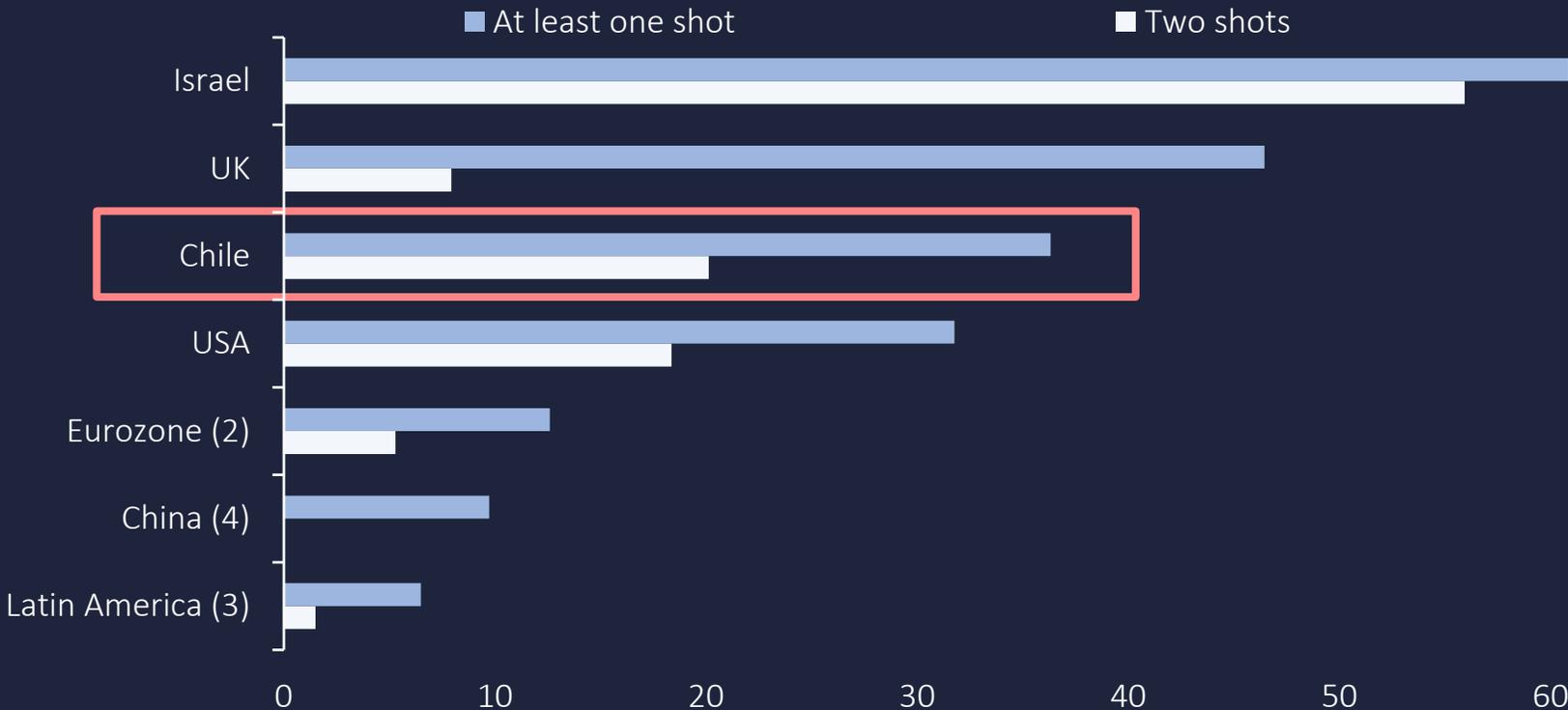
(*) Argentina, Brazil, Chile, Colombia, Mexico and Peru.

Source: Our World in Data.

Vaccination processes have advanced gradually around the world, albeit at different speeds across countries.



Population vaccinated (1)
(percent of total)

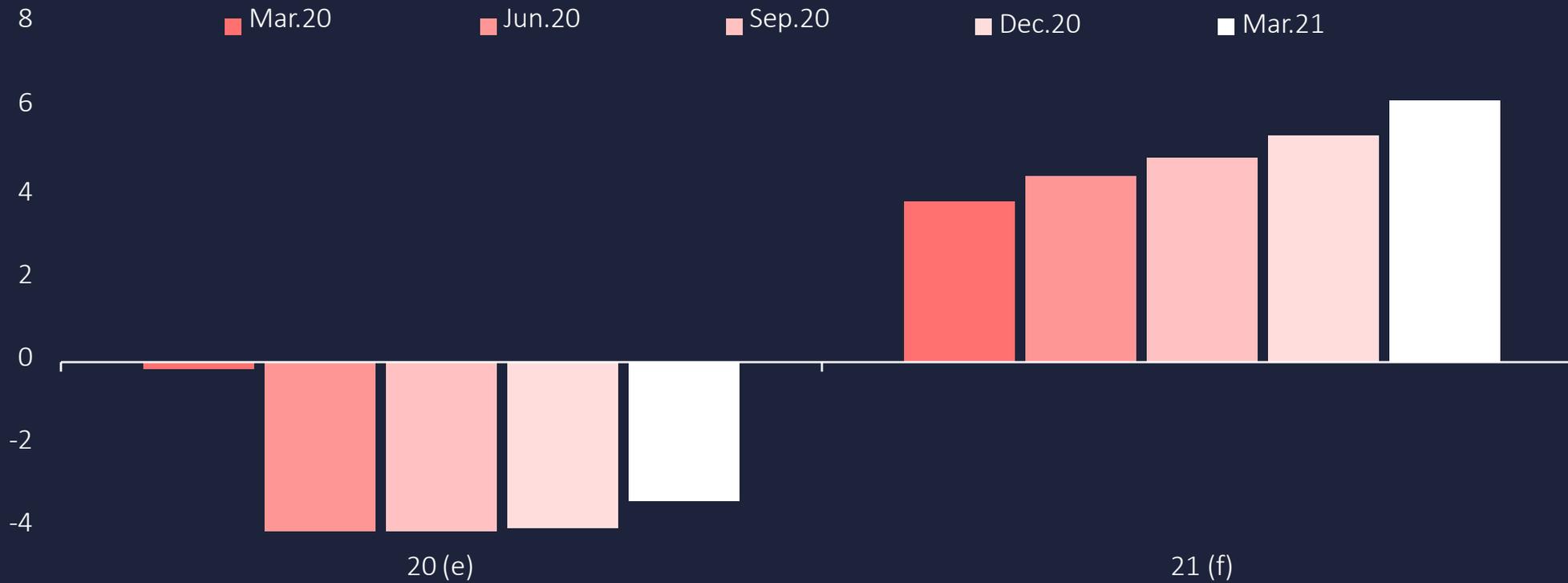


(1) As of April 4, 2021. (2) Germany, Spain, France, Italy average (3) Argentina, Brazil, Colombia, Mexico, Peru average. (4) Total doses.
Source: Our World in Data.

Global activity has recovered faster than anticipated.



World growth forecasts in latest MP Reports
(annual change, percent)



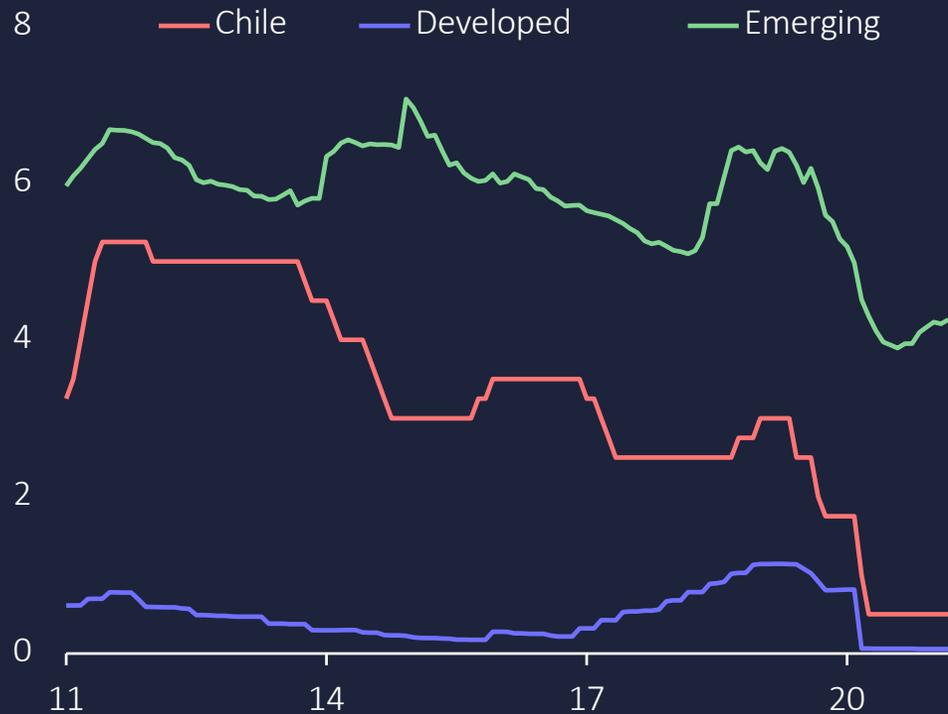
(e) Estimate. (f) Forecast.

Source: Central Bank of Chile.

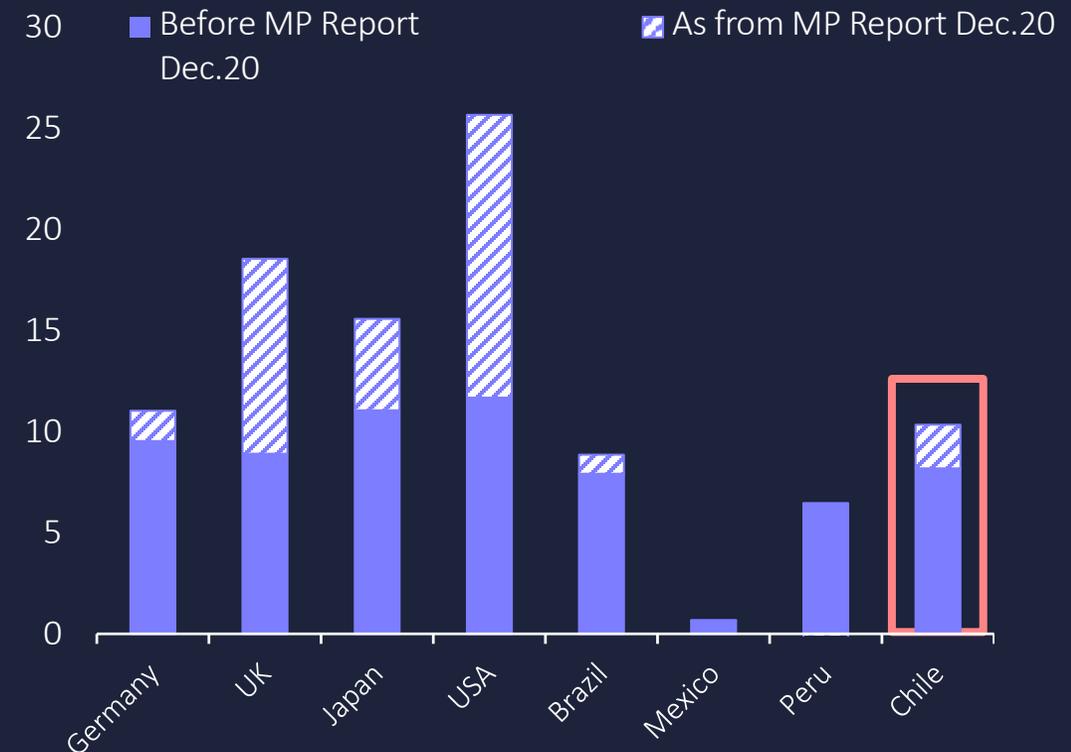
The strong impulse from fiscal and monetary policies has been important for the economic rebound.



Monetary policy rate (1)
(percent)



Fiscal packages announced to address Covid-19 crisis (2)
(percent of GDP)



(1) For developed and emerging economies, GDP-weighted rates at PPP for each one. (2) IMF Fiscal Tracker data as of 22 March, 2021. Corresponds to additional spending and revenue foregone by governments in response to Covid-19. The extra spending is the difference between January and October update plus changes occurred after the statistical cutoff date of December's Monetary Policy Report (December 2, 2020).

Sources: Central Bank of Chile, Bloomberg, and International Monetary Fund.

Global activity recovery has encouraged international trade.

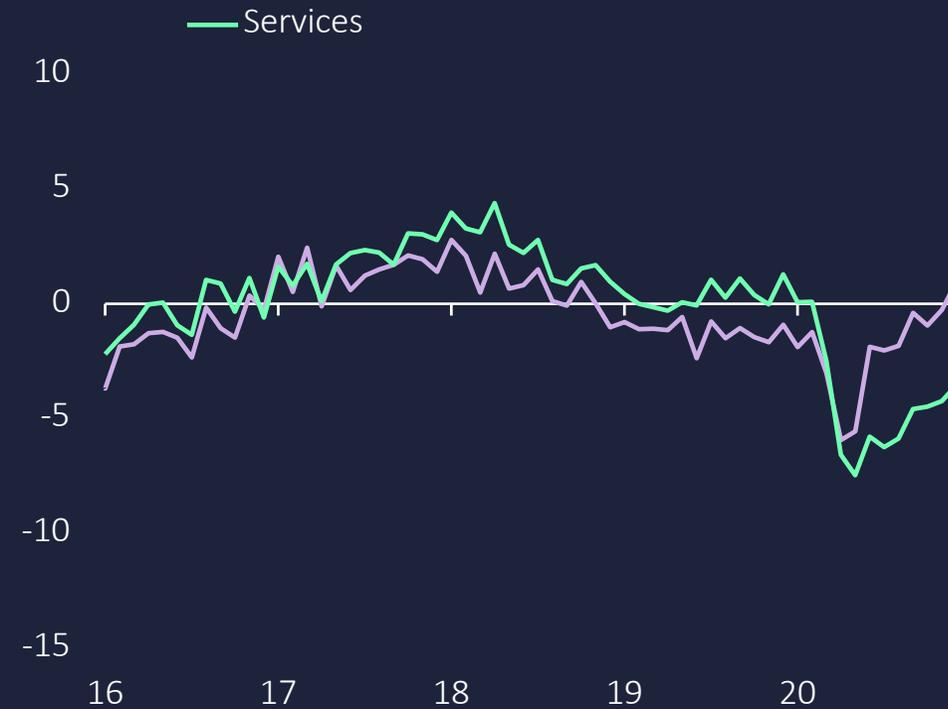


Nominal exports
(annual change, percent)

Developed (1)



Emerging (2)



(1) Includes Australia, Belgium, Canada, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Italy, Japan, Korea, Latvia, Lithuania, Luxembourg, Malta, Portugal, Slovakia, Slovenia, Sweden, United Kingdom and United States. (2) Includes Belarus, Brazil, Bulgaria, China, Hungary, India, Poland, Romania, Russia, Turkey, and Ukraine.

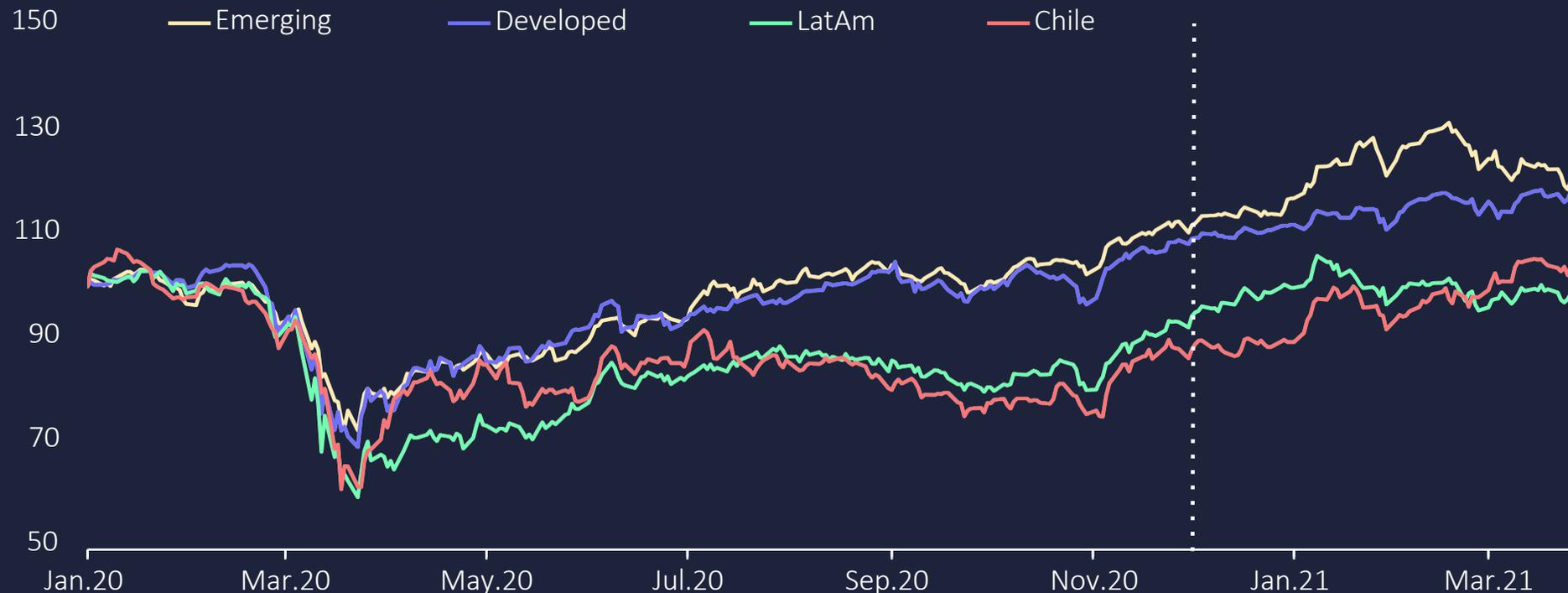
Source: World Trade Organization.

The economic improvement has been reflected in financial markets.



Stock markets (1) (2)

(index, 1 January 2020 = 100)



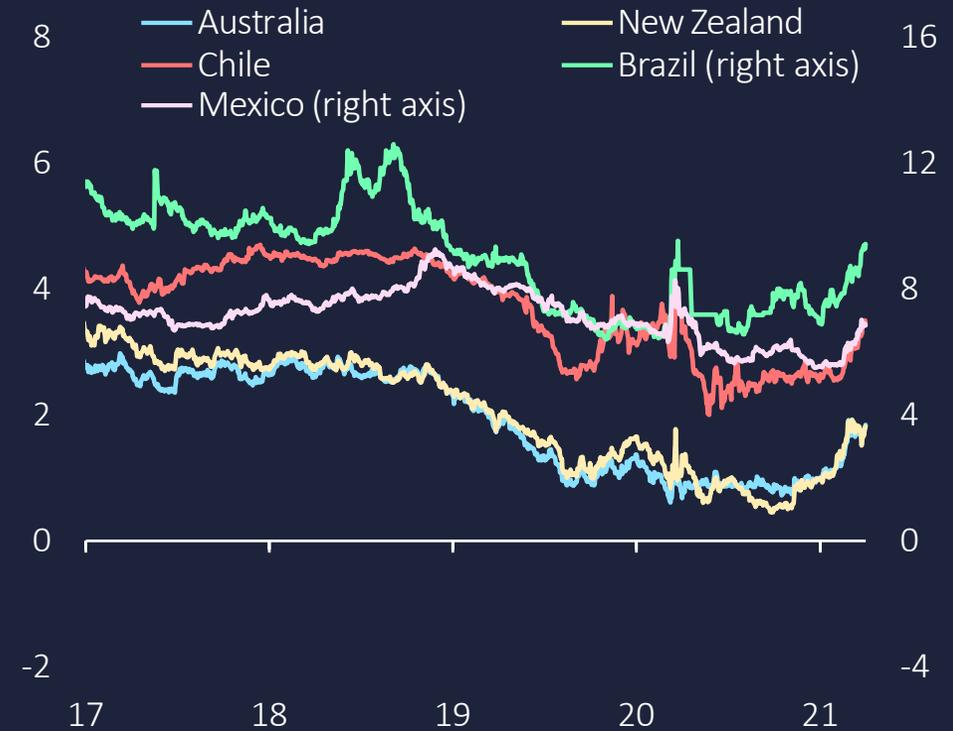
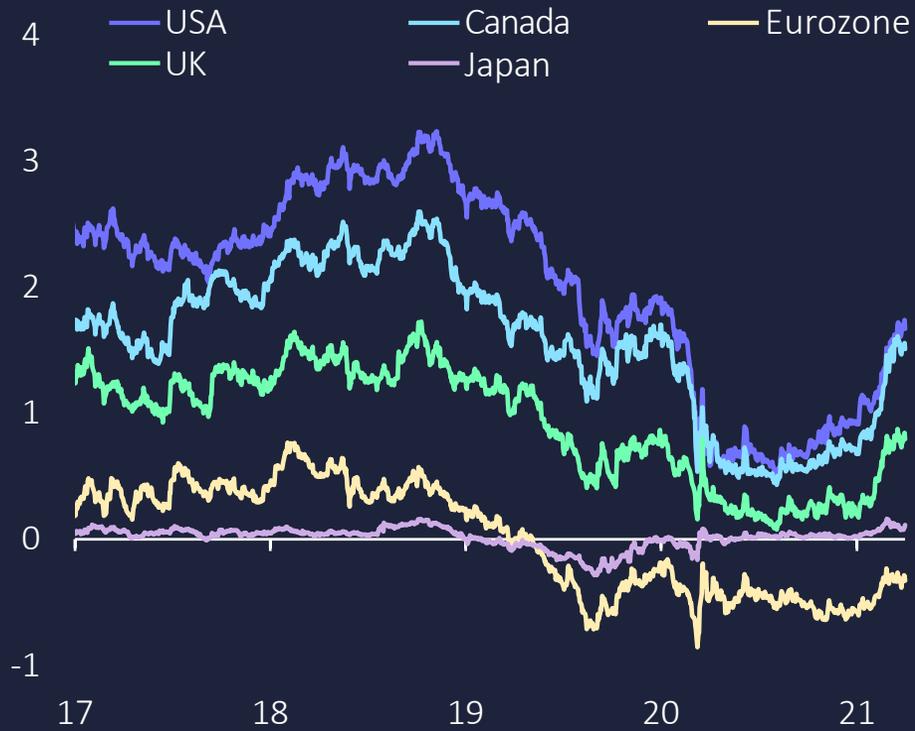
(1) Stock indexes by region measured in local currency by Morgan Stanley Capital International. For Chile, the IPSA is used. (2) Dotted vertical line marks the statistical cutoff date for the December 2020 Monetary Policy Report.

Source: Bloomberg.

In general, long-term interest rates have also responded to the improved growth outlook.



10-year local currency bond yields in selected economies
(percent)

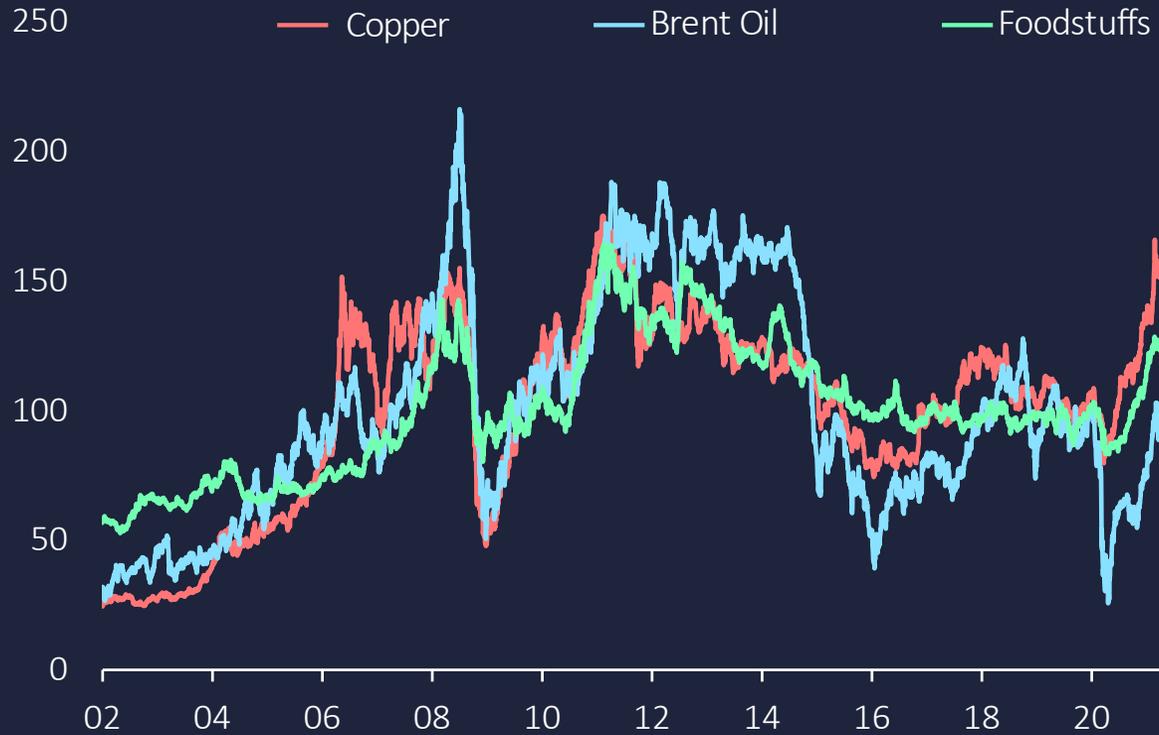


Source: Bloomberg.

Commodity prices are up across the board.



Commodity prices
(2002-2021=100)



Source: Bloomberg.

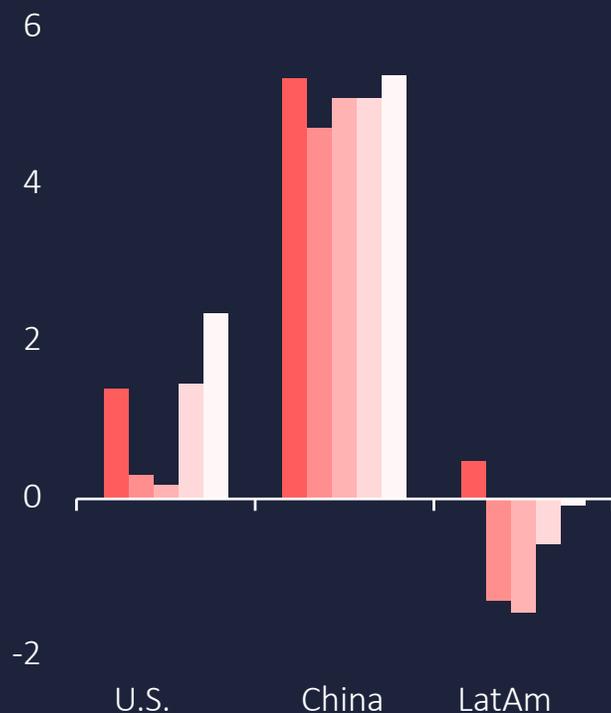
Copper price climbed above US\$4/pound

Oil prices jumped above US\$60/barrel

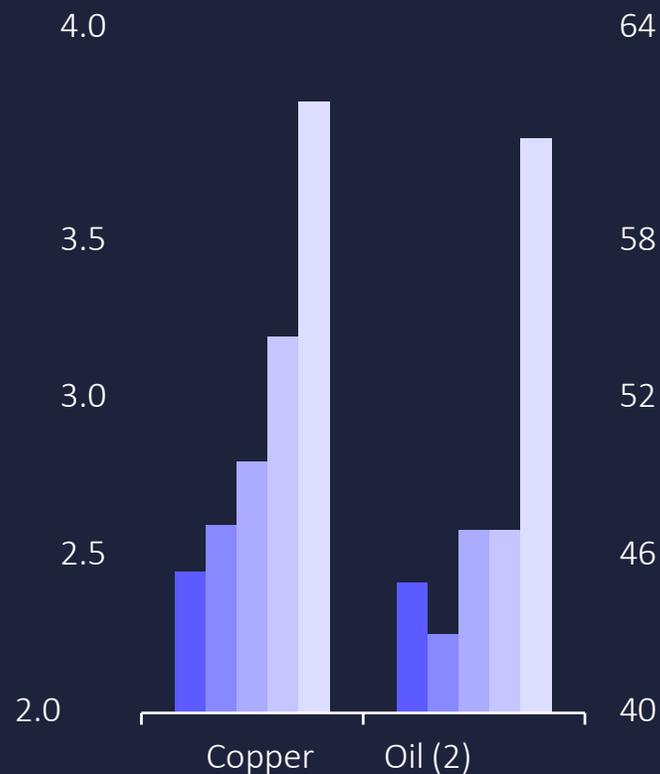


The external impulse has increased significantly.

Growth forecasts in latest MP Reports,
2020-2022 average (1)
(annual change, percent)

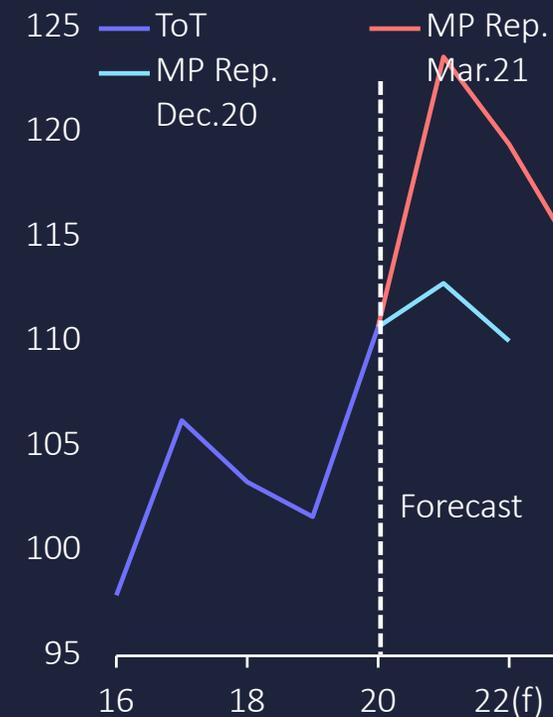


2021 commodity price forecast (1)
(dollars/pound; dollars/ barrel)



Terms of trade

(index, 2013 = 100)



(1) Evolution of forecast from March 2020 to March 2021 Monetary Policy Reports. (2) Simple average between WTI and Brent.
(f) Forecast.

Source: Central Bank of Chile.

Locally, the recovery of the economy has been faster than expected, but quite uneven across sectors.



IMACEC by sector

(seasonally-adjusted series, February 2020 = 100)



Source: Central Bank of Chile.



2020
-5.8%

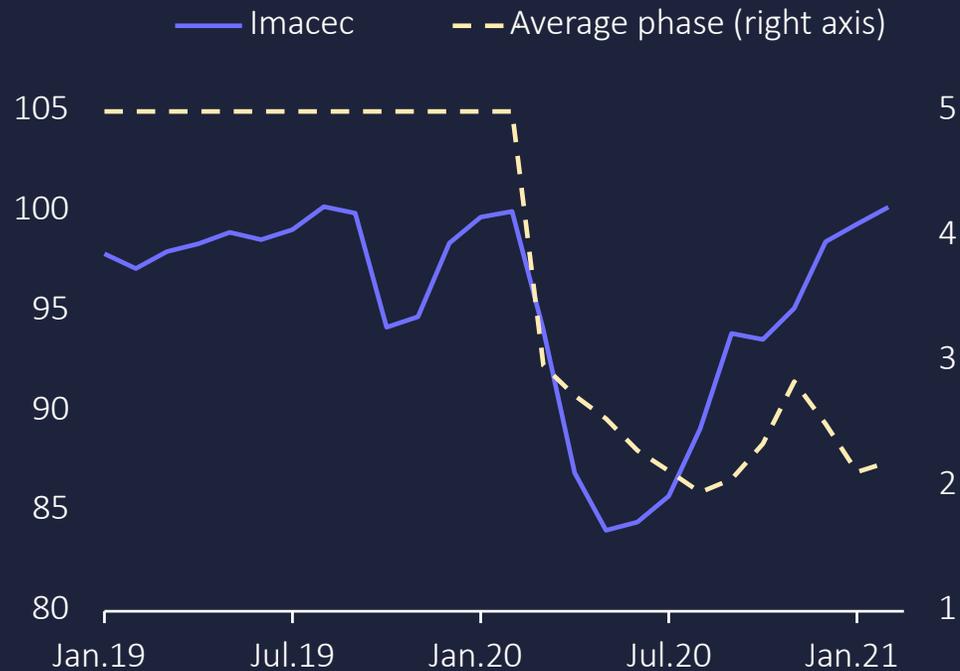
MP Report Dec. : -6.25/-5.75%

Successful adaptation of households and businesses has been critical in the improved performance of the economy.



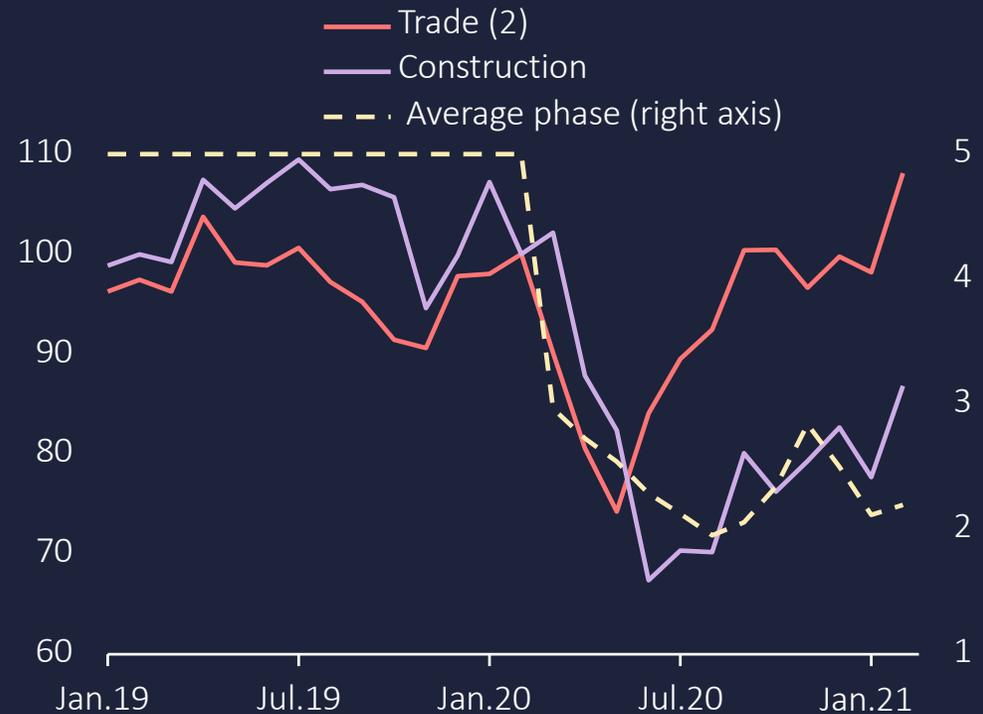
Population by phase of Step-by-Step Plan (nationwide) and Imacec

(seasonally-adjusted series; index, Feb.20 = 100; phase)



Population by phase of Step-by-Step Plan (nationwide) and digitally-invoiced real sales, by economic sector (1)

(seasonally-adjusted series; index, Feb.20 = 100; phase)



(1) CPI-deflated sales. (2) Includes restaurants & hotels.

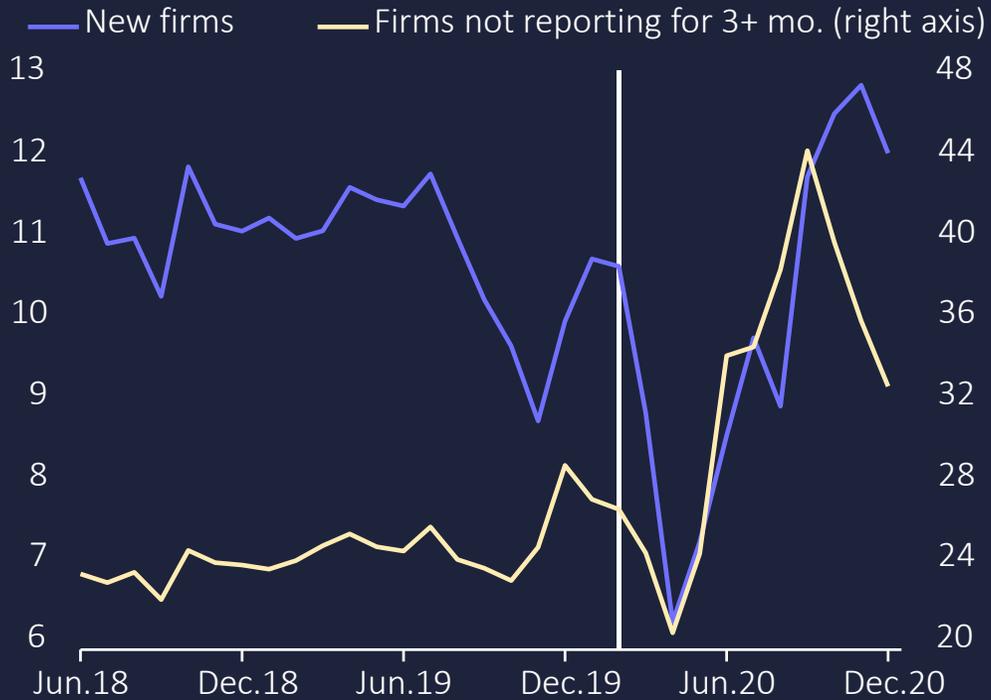
Sources: Central Bank of Chile based on data from the National Statistics Institute (INE), Chile's Health Ministry and Internal Revenue Service (SII).

A significant number of firms have resumed their activities while the creation of new businesses has increased.

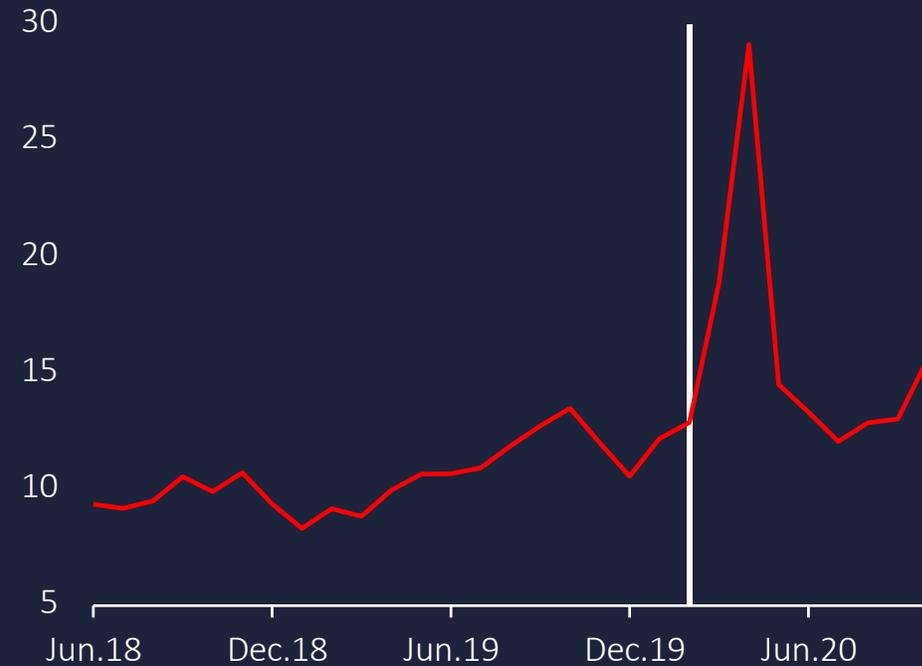


Margins of firms' entry and non-reporting, 2018-2020 (1)
(thousands)

Firms' entry and re-entry (2)



Firms not reporting sales (3)



(1) White vertical line in both graphs indicates February 2020. (2) Blue line shows monthly flow of firms reporting sales for the first time. Yellow line shows firms reappearing after not reporting sales for three or more consecutive months. The latest data is December 2020. (3) Includes the monthly flow of firms that stopped reporting positive sales and have not reported since until the end of the sample in January 2021. For the last months of the sample we adjust for the probability of historical recovery, adjusted for the information obtained in the pandemic months. Last observation: October 2020.

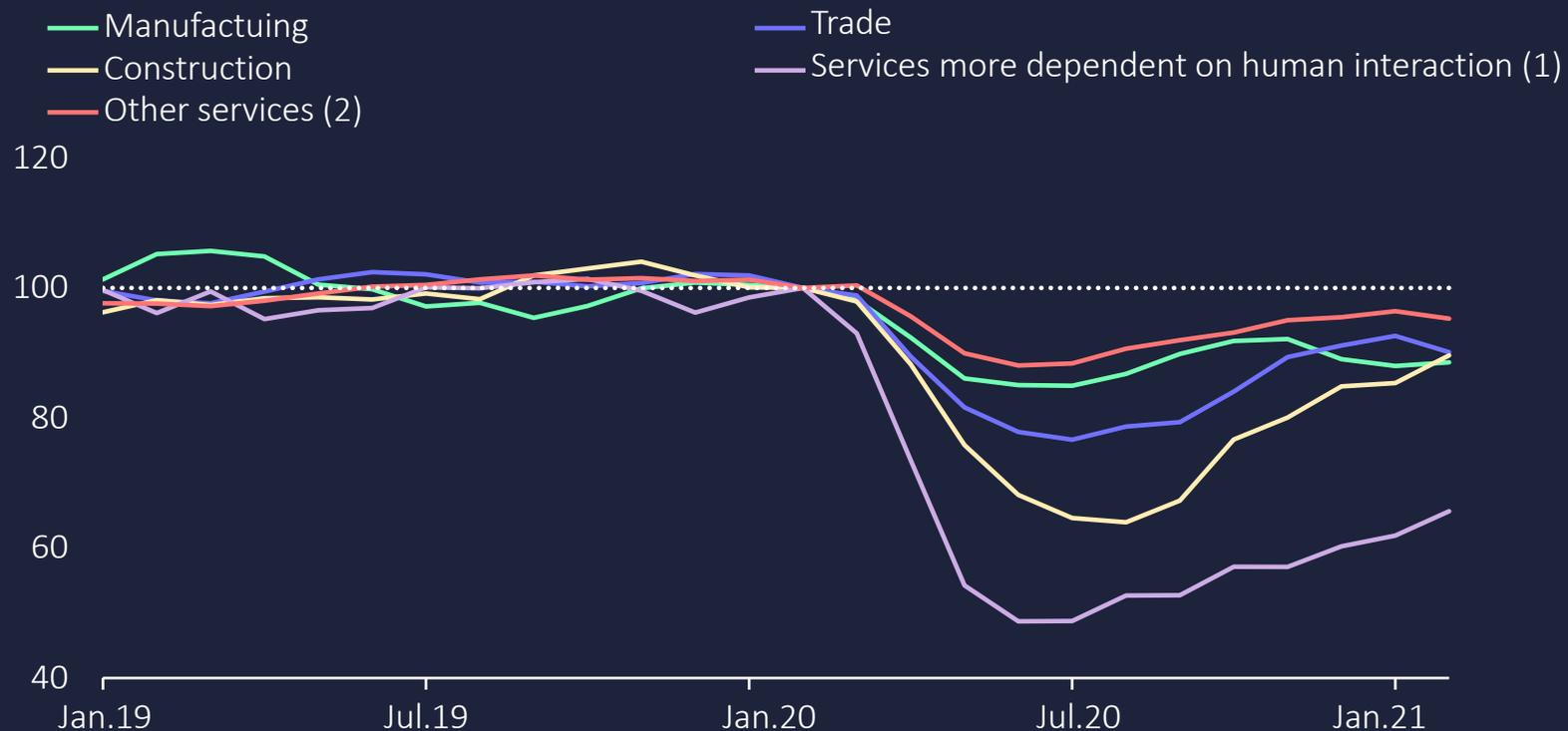
Source: Central Bank of Chile based on Internal Revenue Service (SII) form F29..



Employment has also risen, but with significant lags.

Employment by sector

(index, February 2020 = 100)



To date, 900k jobs have been lost compared to February 2020.

(1) Includes accommodation, food services, and arts, entertainment, and recreation activities. (2) Includes financial and insurance activities; real estate; professional, scientific and technical; administrative and support service activities; public administration and defense; education; human health care and social work activities; other services; activities of households as employers; and activities of extraterritorial organizations and bodies.

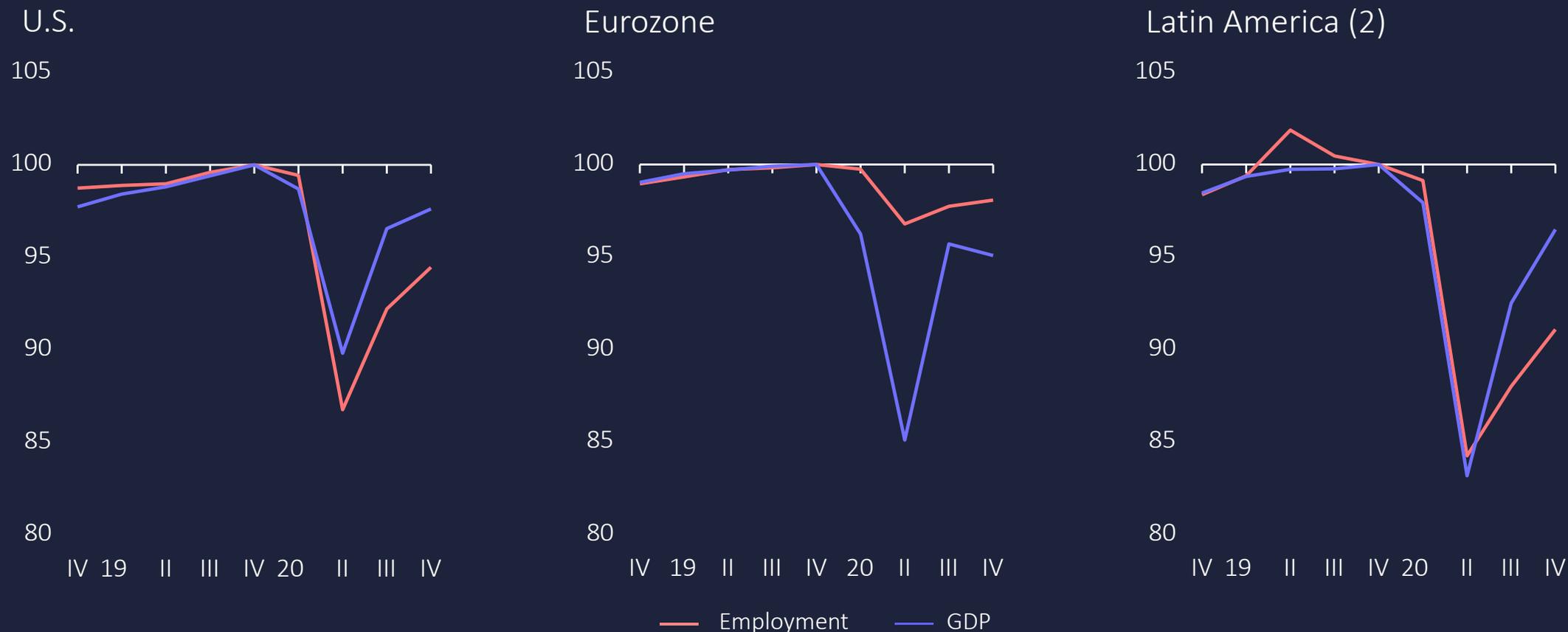
Source: National Statistics Institute (INE).

This is also the case in other economies.



Activity and employment (1)

(index, IV.19 = 100, seasonally-adjusted series)



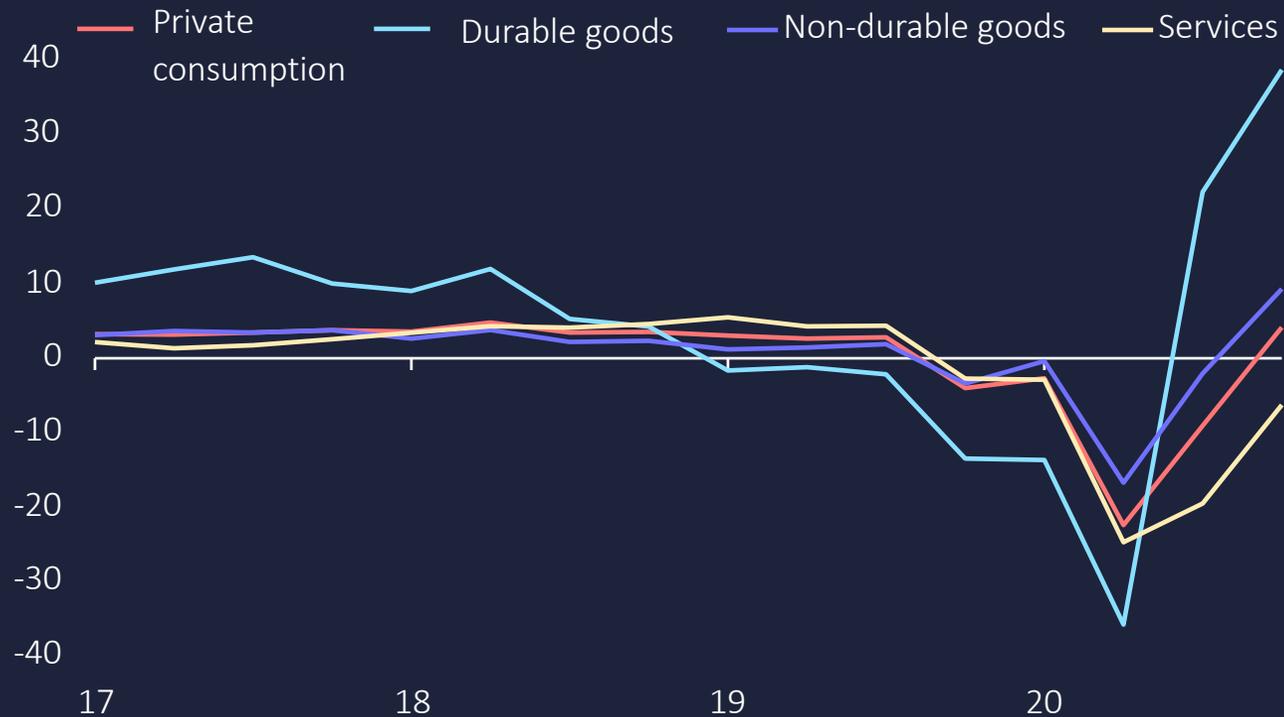
(1) Quarterly employment data for the Eurozone and 3-month averages for the U.S. and Latin America. (2) Represents the median of Brazil, Chile, Colombia, Mexico, and Peru.

Sources: Bloomberg and statistical offices of the respective countries.

Private consumption has been driven by the pension fund withdrawals.



Private consumption by components
(real annual change, percent)



4.1%

growth in private consumption in fourth quarter 2020



Source: Central Bank of Chile.

A significant fraction of anticipated withdrawals have not been spent.



Estimated distribution of first and second pension fund withdrawals (*)

	CLP billion	Percent of total	Percent of GDP
Withdrawn funds at January:	24,500	100.0	12.2
Assets:	15,233	62.2	7.6
Sight and current accounts	8,984	36.7	4.5
Traditional savings	4,092	16.7	2.0
Pension savings	910	3.7	0.5
First-home savings	449	1.8	0.2
Default reduction and rescheduling	798	3.3	0.4
Consumption of goods	3,734	15.2	1.9
Not identified	5,532	22.6	2.8

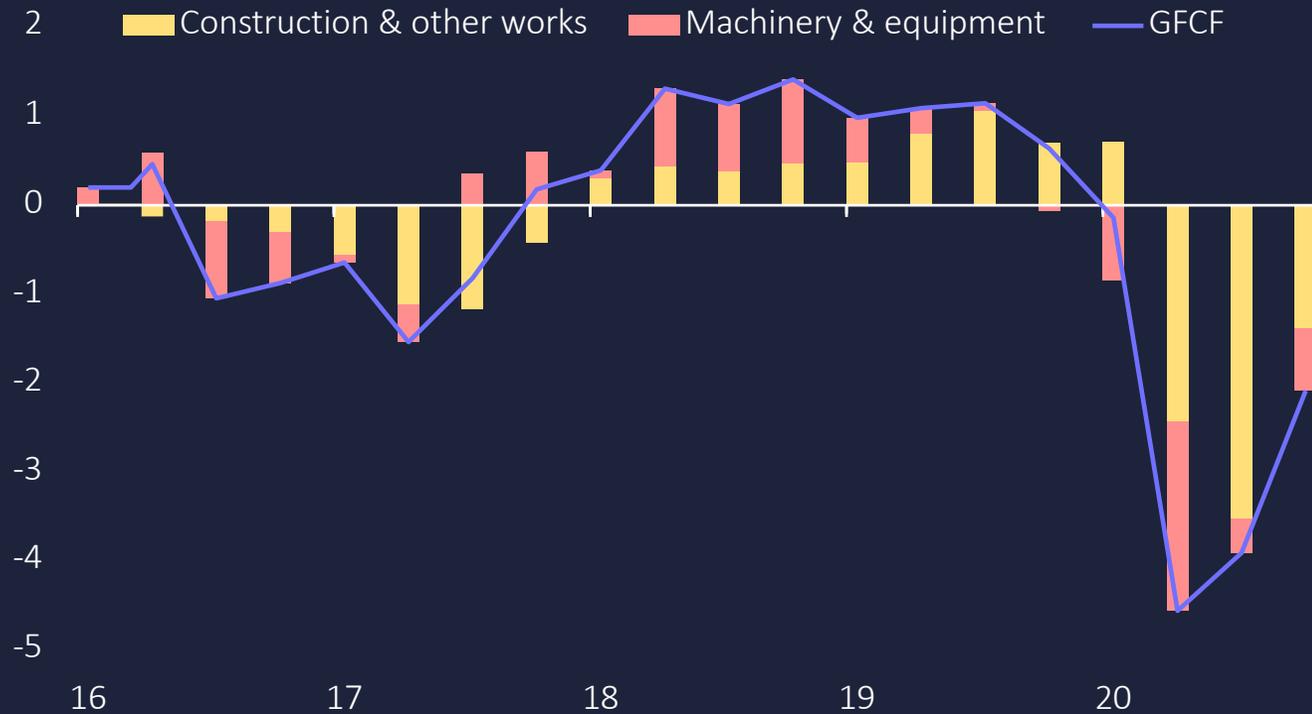
(*) For estimation details, see Chapter V of March 2021 Monetary Policy Report.

Sources: Central Bank of Chile based on Barrero *et al.* (2020), Financial Market Commission, National Statistics Institute (INE), Superintendence of Pensions, and Transbank.

Investment has been much slower to take off.



Gross fixed capital formation by components
(contribution to annual GDP change, percent)



11.5% fall in investment in 2020

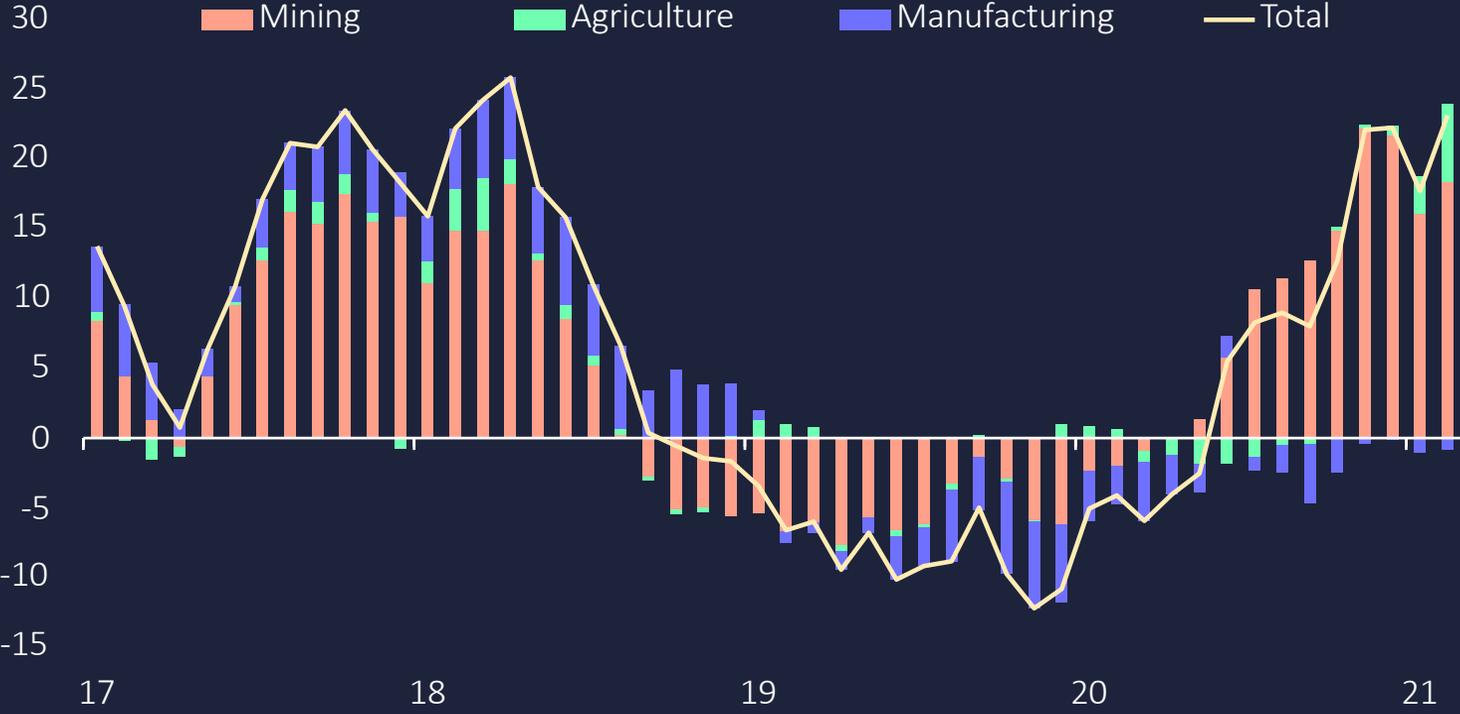


Source: Central Bank of Chile.

The performance of local activity has also been boosted by higher external demand.



Nominal exports
(contribution to annual change, moving three-month average)



Mining exports lead increases, owing largely to copper price hike.



Volume agricultural shipments also show marginal increase.

Source: Central Bank of Chile.

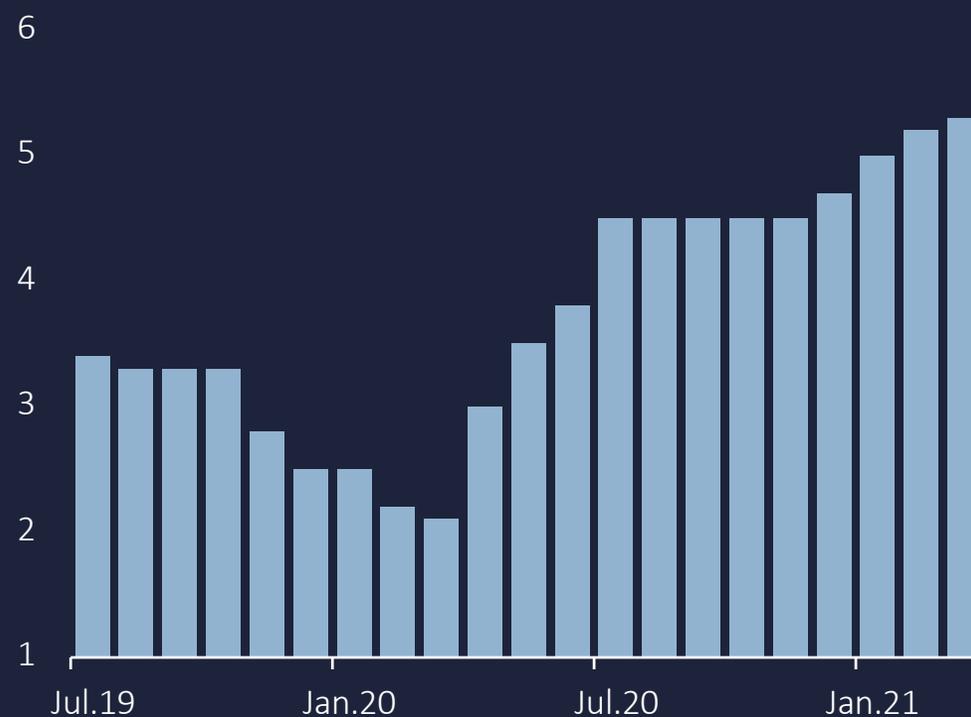


In this context, expectations have shown a rebound.

Expectations of businesses and households (*)
(diffusion index)



EES: growth expectations 2021
(annual change, percent)

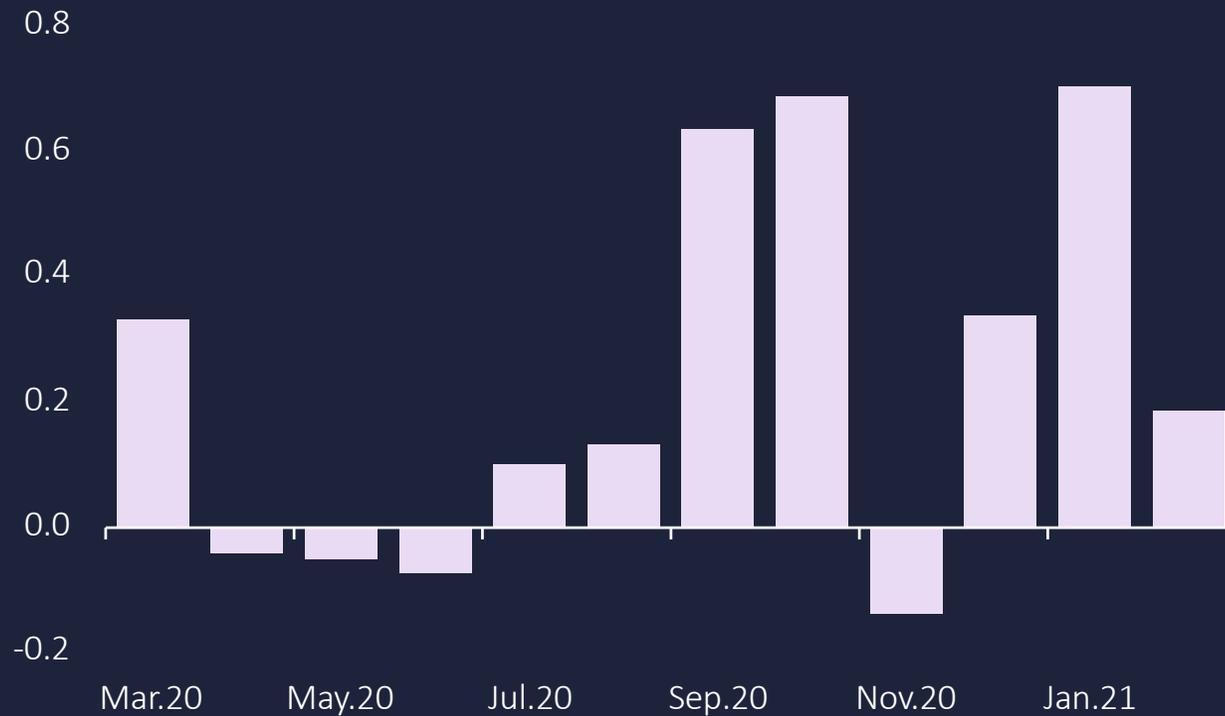


(*) Value above (below) 50 denotes optimism (pessimism). IMCE: Business confidence. IPEC: Consumer confidence.
Sources: Adimark, Central Bank of Chile and Icare/Universidad Adolfo Ibáñez.

Fluctuating inflation is explained by the unique conditions that the pandemic has imposed on the availability of certain goods and services.



Monthly CPI
(monthly change, percent)



Source: National Statistics Institute (INE).

2.8%

annual inflation in
February 2021



Worth noting are price
increases in fuels and fruits &
vegetables since December
MP Report



The outlook for the Chilean economy this year has improved with respect to the December Monetary Policy Report.



GDP growth forecast
(annual change, percent)

2021

December 2020  6.5 %
5.5 %

March 2021  7.0 %
6.0 %

2022

December 2020  4.0 %
3.0 %

March 2021  4.0 %
3.0 %

2023

March 2021  3.5 %
2.5 %

Improvements in 2021 are based mainly on:

Higher starting point of the economy between late 2020 and early 2021.

Positive evaluation of the vaccination process.

More favorable external scenario.

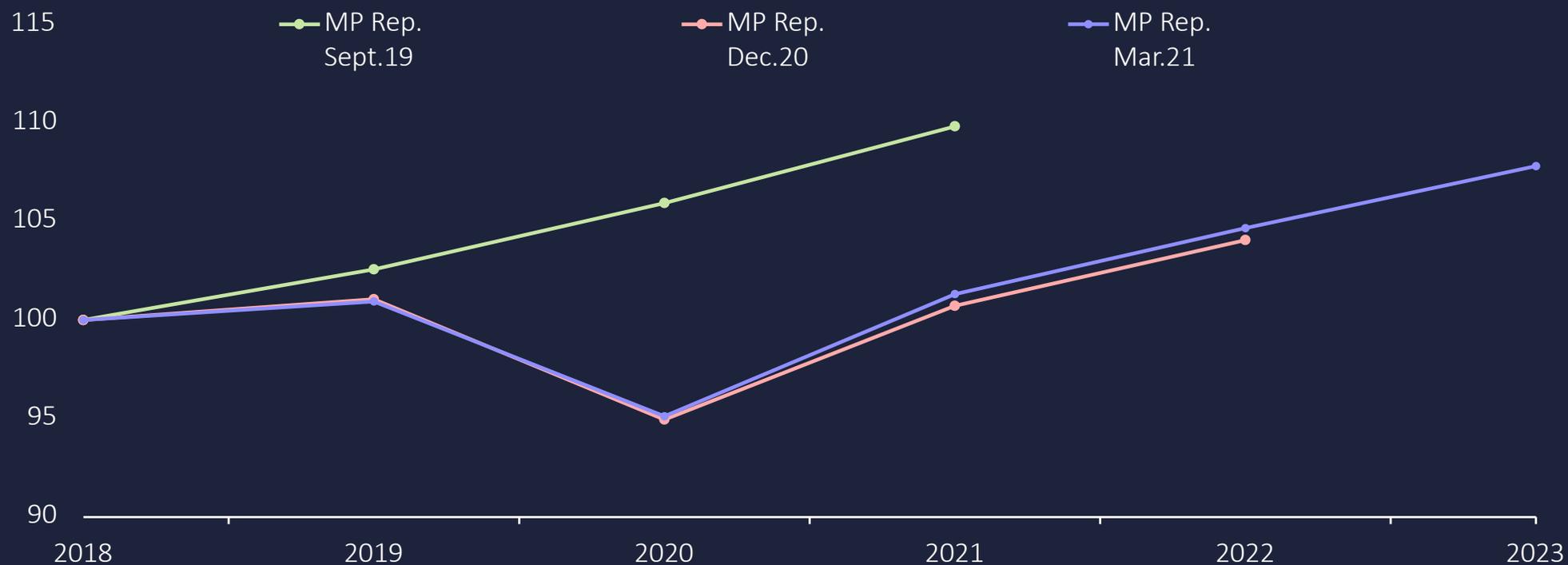
Strong fiscal and monetary policy support.

This scenario continues to include a lower activity path than that estimated prior to the social crisis.



GDP forecast

(index, 2018 = 100)

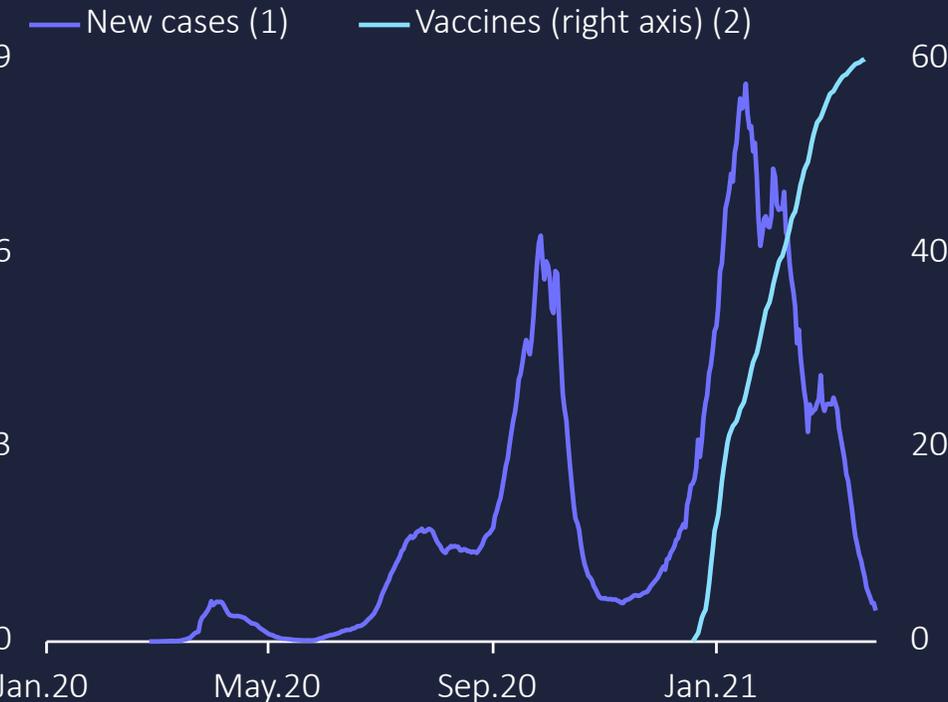


Source: Central Bank of Chile.

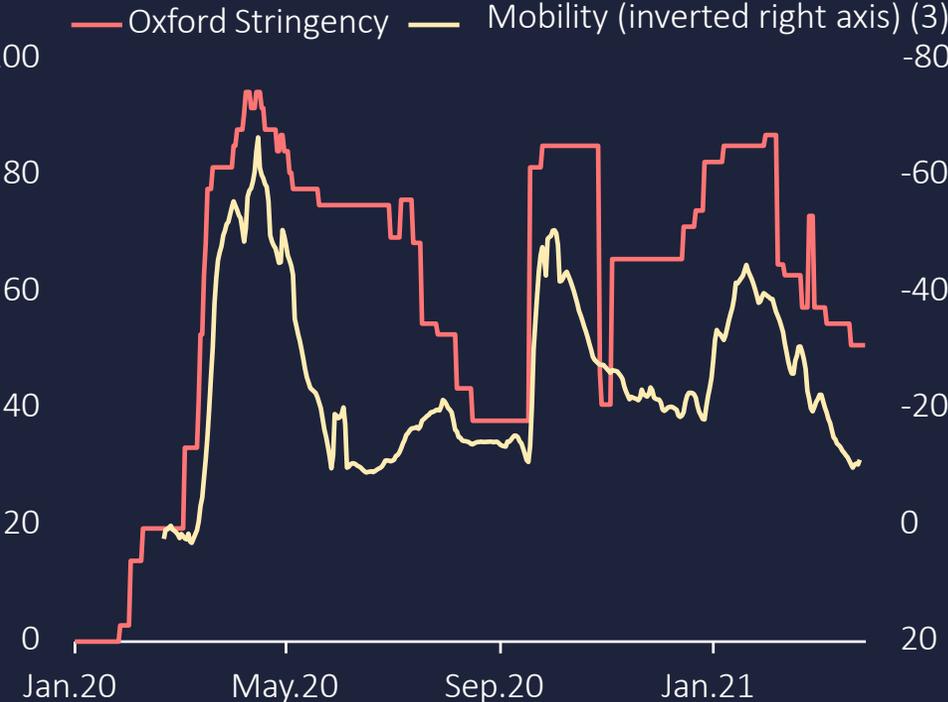
New evidence on the effects of vaccination allows us to foresee an easing of restrictions in the second half of the year.



Israel: new daily cases and vaccinations
(thousands; percent of population)



Israel: constraints and mobility
(index, maximum rigor = 100; moving 7-day average)



(1) Moving 7-day average. (2) Population that received at least one dose. (3) Average of all sub-indicators of the Google Mobility Index, except for parks and residential. Sources: Central Bank of Chile based on Our World in Data; Covid-19: Community Mobility Report (Google), and Oxford COVID-19 Government Response Tracker.

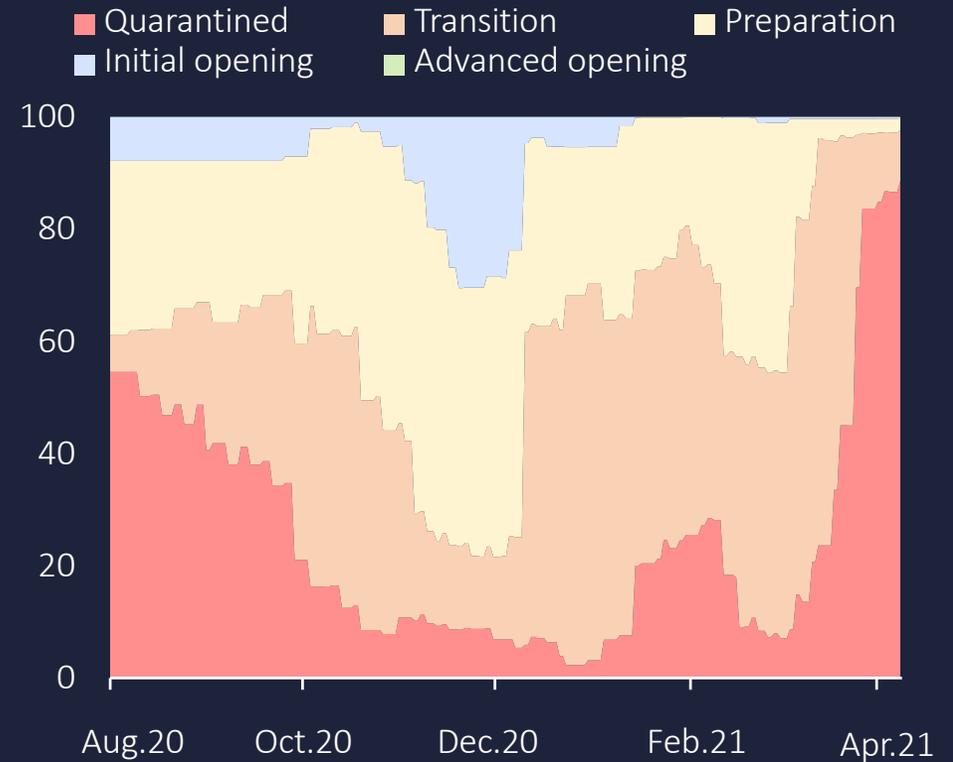


The tightening of restrictions will negatively affect the economy in the immediate future

Daily new Covid-19 cases in Chile
(thousand persons, moving seven-day average)



Step-by-Step Plan: population at each stage (*)
(percent)



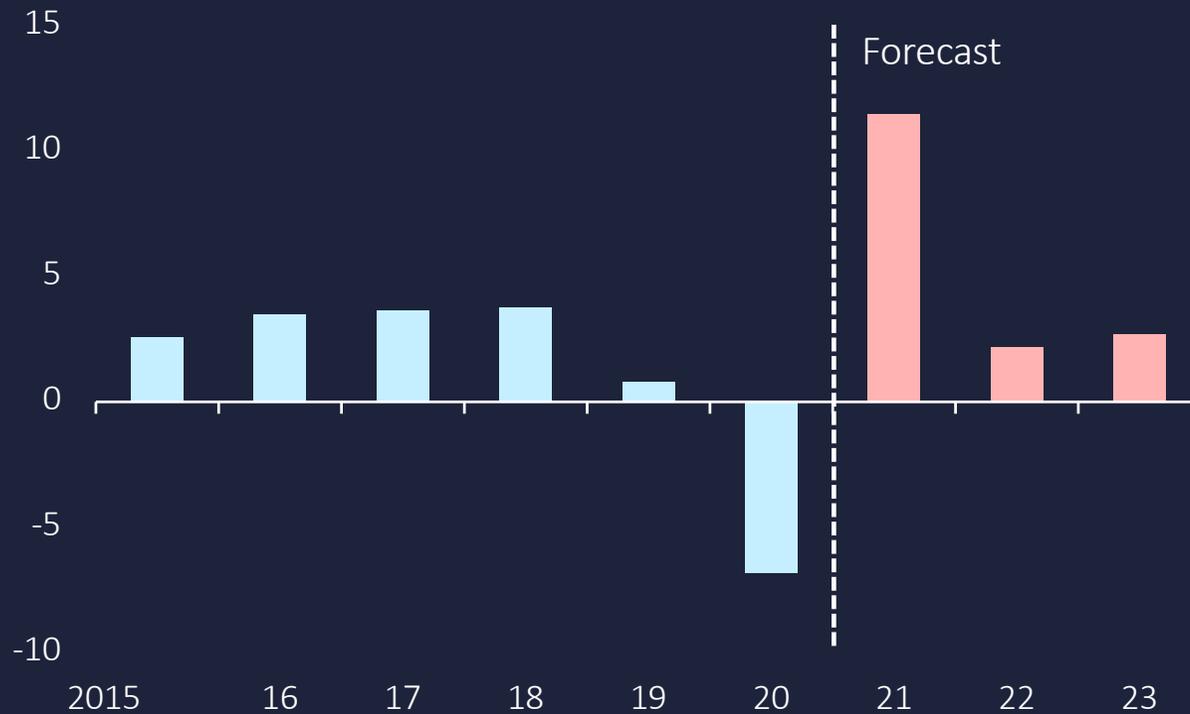
(*) Includes announcement of April 5, 2021.

Source: Chile's Health Ministry.



Consumption will remain highly strong going forward.

Total consumption
(real annual change, percent)



Source: Central Bank of Chile.

Influenced by factors such as:

Liquidity provided by pension fund withdrawals

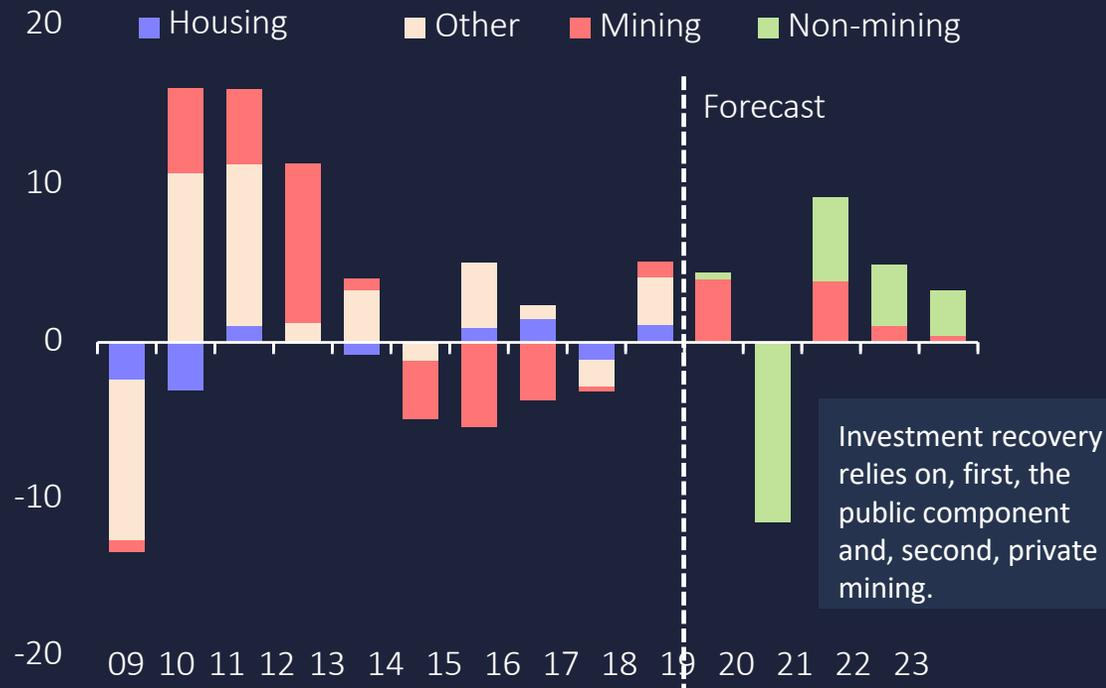
Recovery of activity and employment



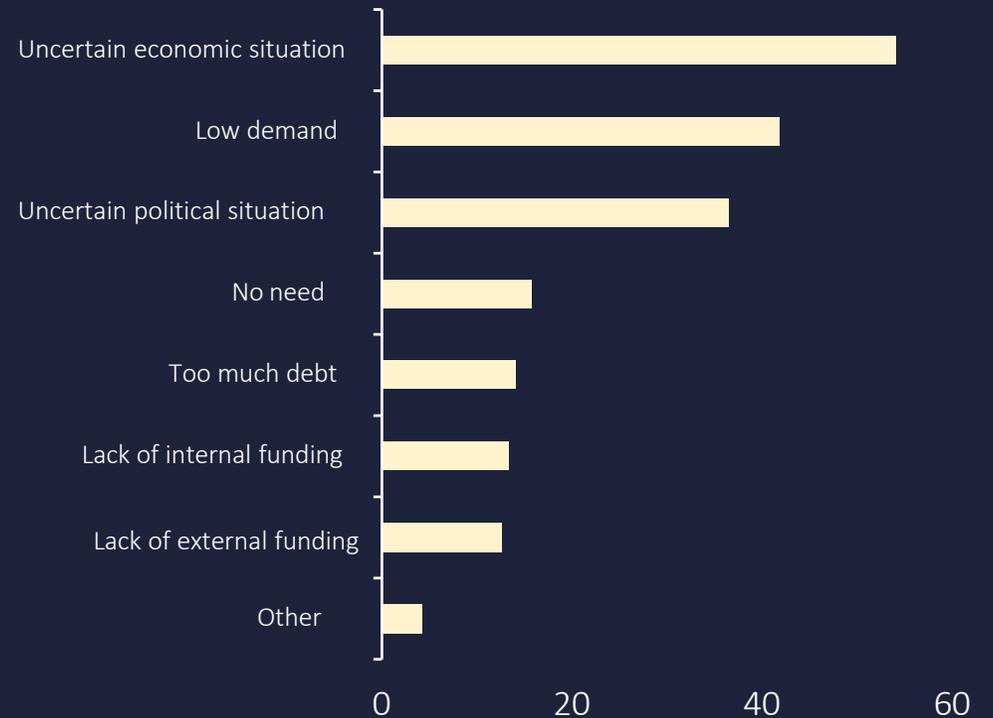
Slow recovery in investment continues to be expected amid still high uncertainty



Real annual contributions to GFCF (1)
(percentage points)



BPR (2): Why do you think your firm will not invest in 2021?
(percent of responses)

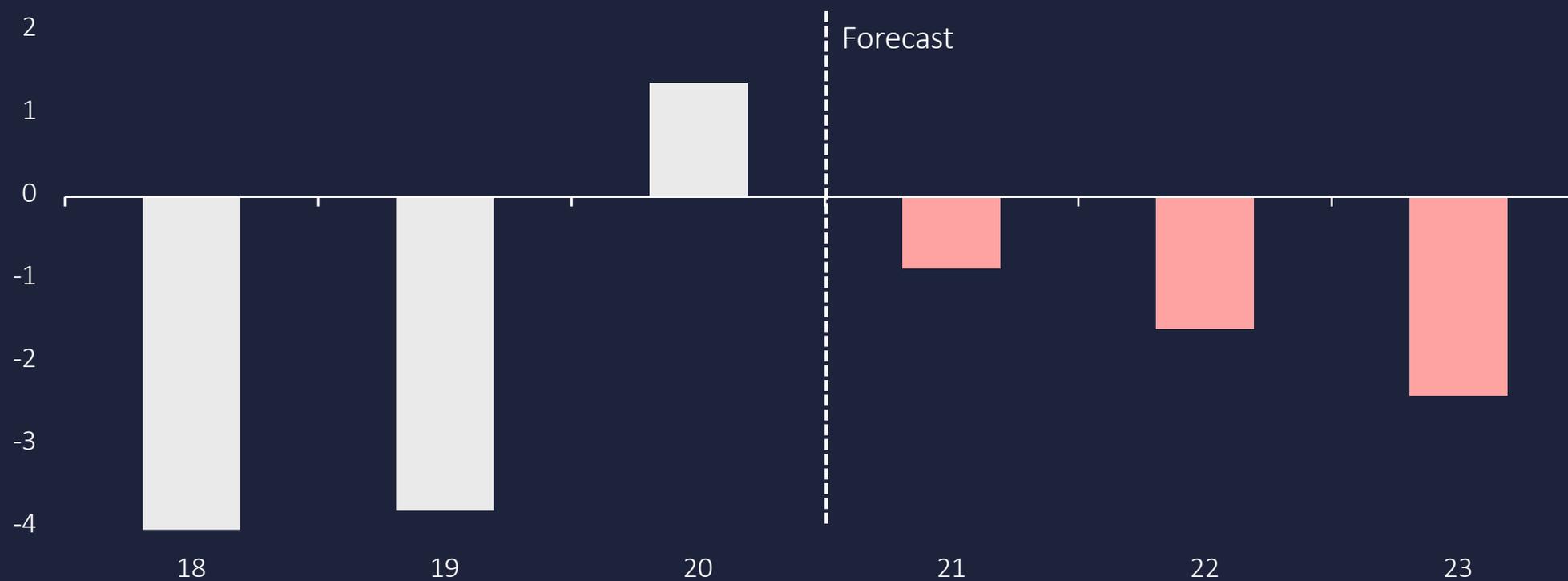


(1) Up to 2018, actual data. Total GFCF for 2019-20 as published on 18 March 2021. The remaining GFCF component is treated as a residual. The 2019-2022 estimations use Central Bank projection models and sectoral sources, such as Corporation of Capital Goods survey and investment plans. (2) BPR: Business Perceptions Report Source: Central Bank of Chile.

The expected rebound in consumption and investment will contribute to the current account returning to a deficit.



Current account of balance of payments
(percent of GDP)



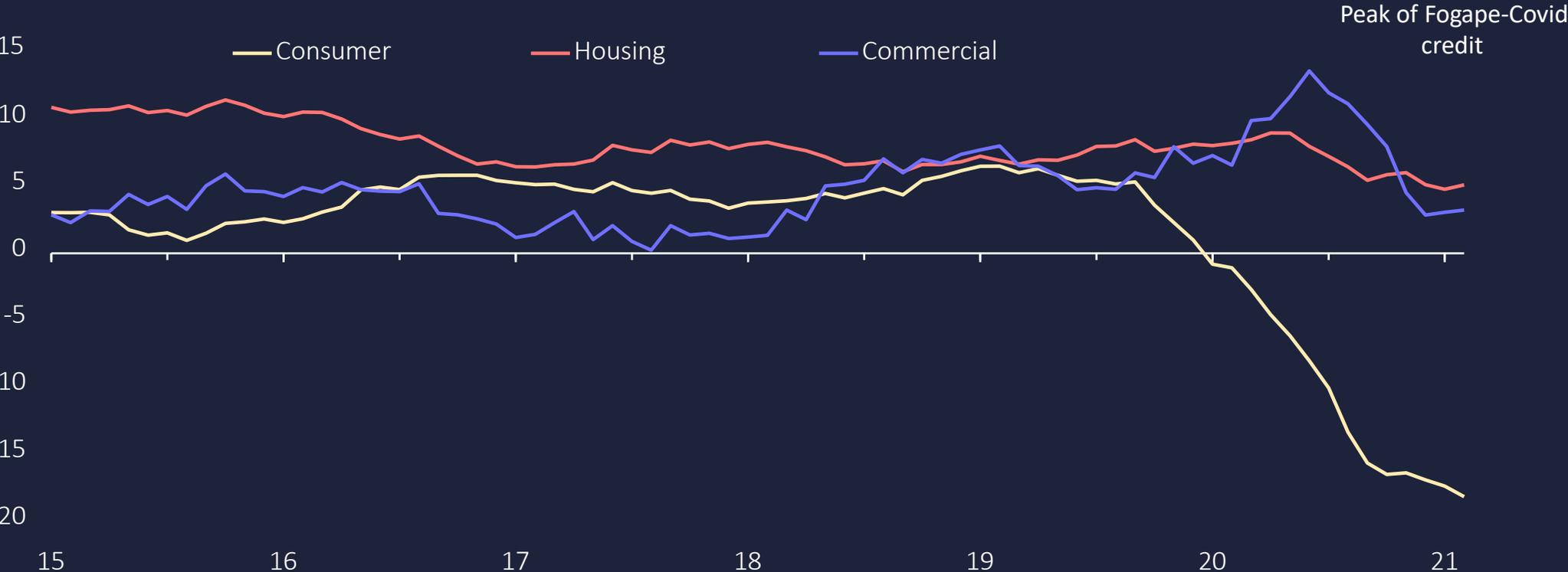
Source: Central Bank of Chile.

Commercial credit has decelerated since mid-2020 as emergency financing needs have been overcome.



Real loans

(annual change, percent)



Source: Central Bank of Chile.

In fact, the credit instruments have been adapted to the new needs of firms.



FCIC

FCIC1+FCIC2 = US\$30.0 billion

FCIC3

Extension of collaterals eligible in previous stages.

Total available: US\$10.0 billion (remainder from FCIC2 and FCIC3)

Used to date: around 15%



FCIC1+FCIC2+FCIC3 → Increase of around 15% of GDP in the economy's liquidity

Fogape-Reactiva

Extension of Fogape-Covid use to adapt to new needs of the firms.

Makes funds available for refinancing—including Covid lines—and investment, as well as for working capital.

Special benefits for the hardest hit sectors: hotels, tourism, and others.

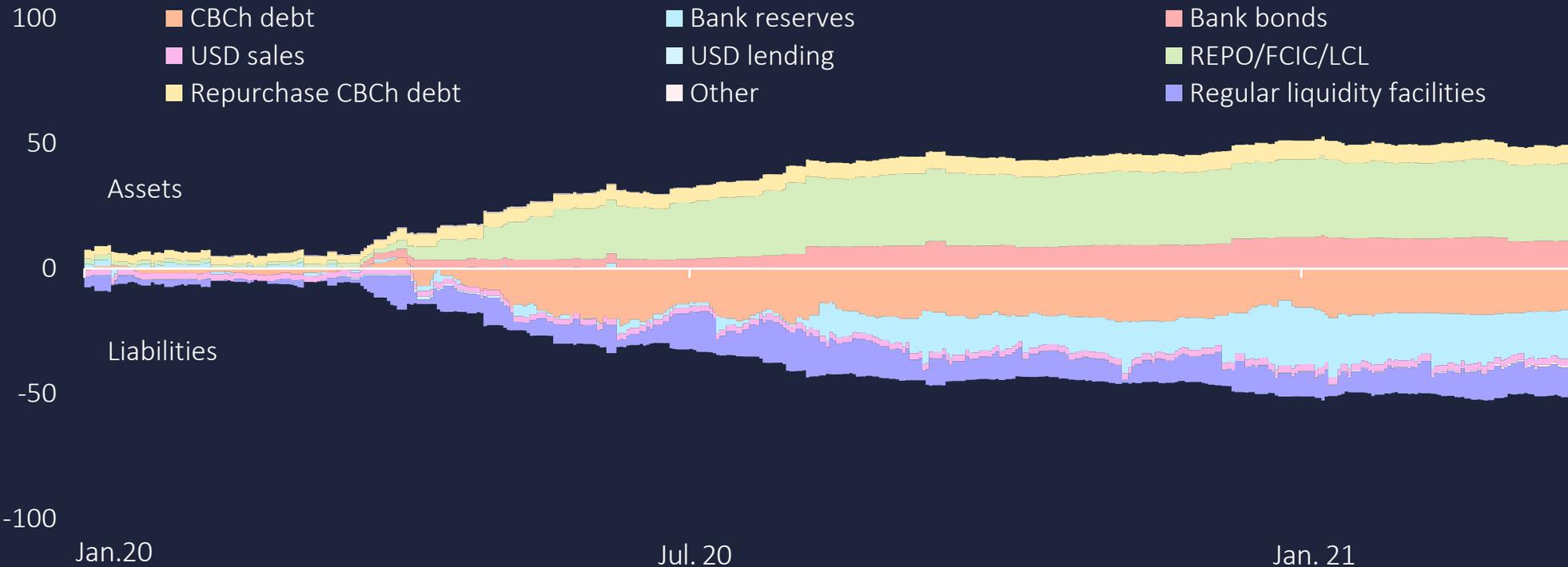


Used to date: around US\$2.0 billion

The Central Bank has adopted important set of measures to support the economy by expanding the size of its balance sheet.



Asset and Liability dynamics of the Central Bank of Chile's balance sheet
(USD billion)



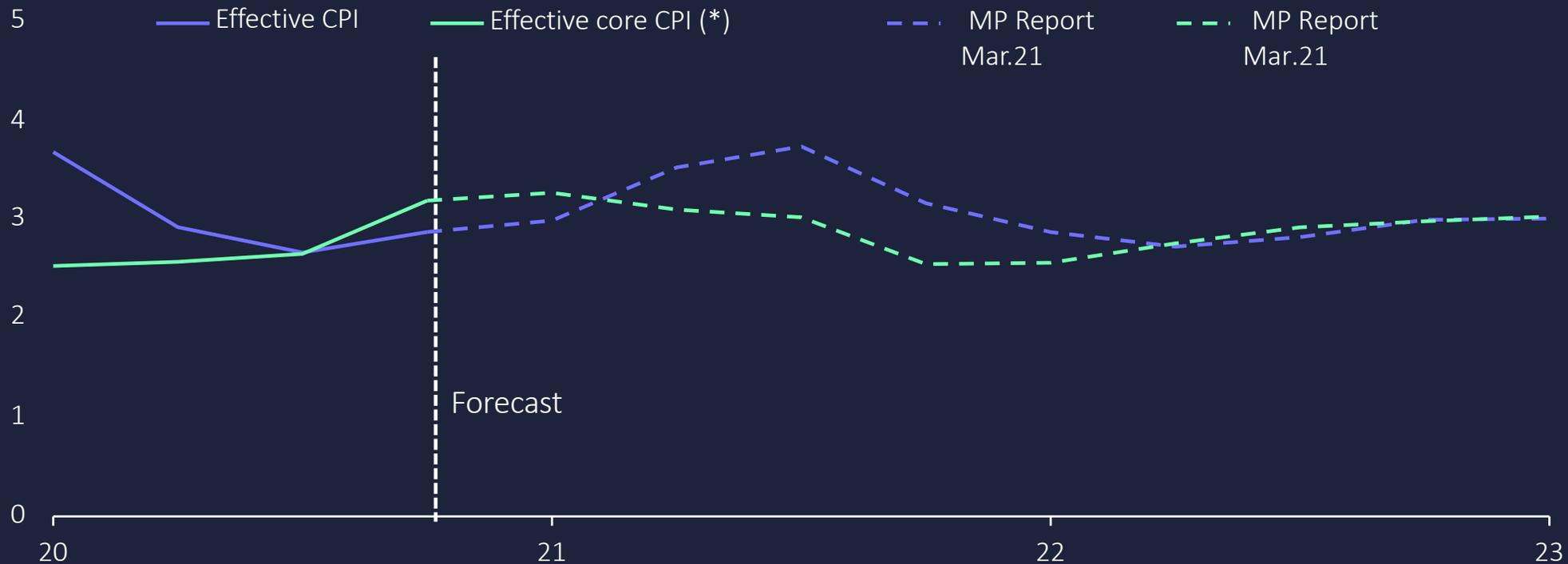
Source: Central Bank of Chile.

In the central scenario, annual inflation will rise to close to 4% in the coming months, influenced by volatile part of inflation.



Inflation forecast

(annual change, percent)



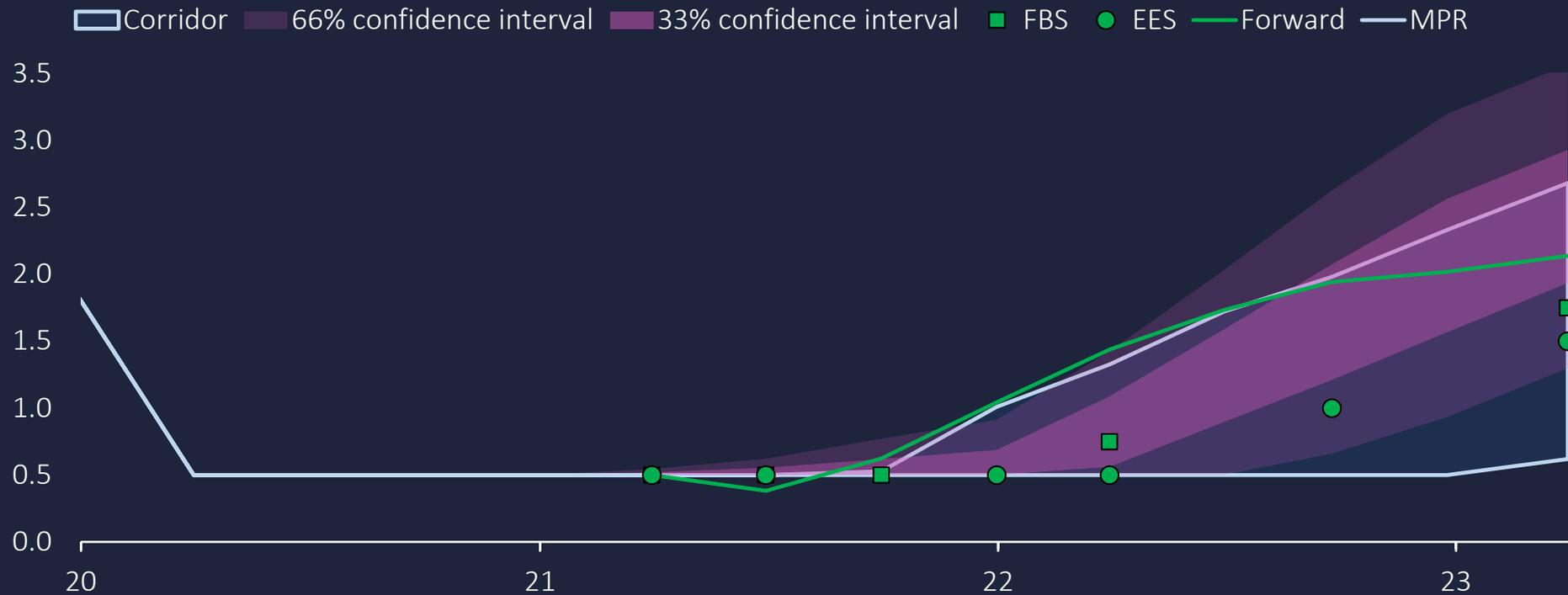
(*) Measured using CPI minus volatiles.

Sources: Central Bank of Chile and National Statistics Institute (INE).

MPR will be held at its 0.5% minimum until the recovery of the economy takes hold and spreads to the more lagging components of expenditure, which will take several quarters.



MPR Corridor (*) (percent)



(*) See V.1 Box of March 2020 MP Report. Confidence intervals reflect historical dispersion. FBS: Financial Brokers Survey. EES: Economic Expectations Survey.
Source: Central Bank of Chile.

There are sensitivity scenarios where the evolution of the economy could require adjusting the monetary impulse.



Positive



Possible reasons:

- Increased consumption due to use of savings as economy opens



Implications:

- Acceleration of consumption
- Positive impact on activity, employment and inflationary pressures



Negative



Possible reasons:

- Delay in opening of economy
- Slower recovery of labor market
- Bigger lag of investment



Implications:

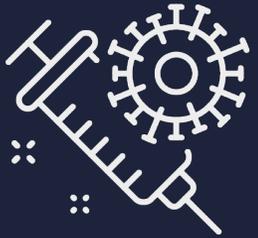
- Deterioration of agents' expectations
- Delayed recovery, with negative effects on inflationary pressures

Risk balance unbiased for activity and inflation

Risks:

Adverse pandemic evolution and global financial turmoil

Concluding remarks



Activity in Chile and worldwide has continued to recover. However, several risks remain relating to the unprecedented shock caused by the pandemic. On the one hand, the epidemiological evolution is still complex, which adds uncertainty to the when and how sanitary restrictions will be eased.

On the other hand, the recovery remains heterogeneous, with significant lags in the sectors that are most intensive in social interaction, which helps to explain the big gaps that persist in the labor market.



Globally, the correct calibration of monetary and fiscal stimuli in terms of their size, scope, and permanence is key, in order to support the recovery without generating macro-financial imbalances.

Concluding remarks



Equally important are the wounds that the pandemic will inflict on households and businesses, including the deterioration of their net worth and its impact on the future dynamism of the economy.

As always, the future path of monetary policy will be subject to the evolution of the macroeconomic scenario and how it will affect the achievement of the inflation and financial stability objectives.





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