MONETARY POLICY REPORT
PRESENTATION BEFORE THE FINANCE COMMISSION OF THE HONORABLE SENATE OF THE REPUBLIC*

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*Visit the December 2019 *Monetary Policy Report* at http://www.bcentral.cl.

Mr. President of the Finance Commission of the Senate, Senator Ricardo Lagos-Weber. Senators members of this Commission, ladies, gentlemen,

Thank you for your invitation to present the vision of the Board of the Central Bank of Chile on the latest macroeconomic developments, their outlook and implications for monetary policy. This view is contained in detail in the December 2019 *Monetary Policy Report* we released this morning. Its contents provide the background for the decision adopted by the Board at yesterday's Monetary Policy Meeting.

I will begin by thanking this Commission for accepting our request to anticipate the delivery of this Report, originally planned for next Monday. The country is going through complex times that are being strongly reflected on the economy, as is to be expected. This is confirmed by the sharp fall in October's *Monthly Economic Activity Index* (Imacec), and several sources of information showing a significant loss of jobs during November and the abrupt fall in the confidence of households and businesses. In such circumstances, it felt important to be able to integrate this information to a medium-term perspective as soon as possible.

The crisis that broke out on October 18 unveiled social demands that have led to the discussion of important institutional changes—including a New Constitution—and legitimate pressures for social benefits and rights with major fiscal implications. This process, however, has been accompanied by severe and prolonged episodes of violence, which have triggered major disruptions in the productive system, resulting in an activity downfall and weakening employment.

Knowing the objectives and demands that the law imposes on the Central Bank of Chile, it is not our role to opine on the causes of the social unrest, its different manifestations and possible solutions. For this there are abundant analyses and reflections by various players and observers of the social and political reality of the country. This Report will concentrate only on its economic dimensions and, as usual, its implications for macroeconomic policy, and monetary policy in particular. We believe this approach adds value, because the worst thing that can happen to a social and political crisis is for it to be compounded by an economic crisis, where resources and possibilities for solving the problems would be considerably limited, so others of similar or greater magnitude could arise. The history of Latin America has lived too many episodes of this nature for us to ignore.

As we will see, the current macroeconomic outlook is cause for an additional degree of concern. The magnitude of the impact of the social crisis is comparable to some of the major shocks endured in the past by the Chilean economy. Damping this impact will involve using up much of the gaps and resorting to the experience accumulated by the economic authorities over the years. In fact, only those gaps and an adequate economic policy framework will make it possible to cushion, though not eliminate, the likely consequences of this macro scenario on employment, growth and prices.

While part of the impact of the social outbreak on the economy takes the form of difficulties in the functioning of the productive system, another, very significant, part has to do with the financial system. The available information shows a significant increase in uncertainty and a deterioration in confidence that seems to be amplifying these effects. Financial markets have been strained by sharp price movements, which in some cases have gone beyond what the greater perception of country risk would justify. At the Board we have adopted various measures to improve liquidity in pesos and dollars, and we decided to intervene in the forex market to mitigate the high volatility of the exchange rate and help the adjustments to occur in an appropriate manner.

Consistently with this and with the convergence of inflation to the target, we kept the Monetary Policy Rate (MPR) at 1.75% at the Monetary Policy Meeting we held yesterday. The greater fiscal impulse recently announced, coupled with the already highly expansionary monetary policy, will help to contain the deterioration of the economy, so that after a contraction of 2.5% in the fourth quarter of this year, it should grow between 0.5% and 1.5% in 2020.

Although we anticipate that the significant slowdown in growth will widen the activity gap on the monetary policy horizon pulling down inflation, the financial impacts of greater uncertainty, as well as the more persistent effects of the peso depreciation, will increase inflationary pressures on the policy horizon. Accordingly, we consider that the monetary stimulus is adequate for the achievement of the inflation target, bearing in mind the current state of the fiscal impulse and the forex policy. Market expectations, which foresee no major adjustments in the MPR and which maintain a two-year inflation expectation of 3% over two years, are consistent with this diagnosis.

I must stress that the projections in this Report were constructed in a context of greater uncertainty than usual. The baseline scenario assumes a pattern of economic recovery that starts shyly in December and then continues with a gradual improvement in demand. A crucial condition for this scenario to materialize is a significant decrease in uncertainty and that the different economic sectors can resume their productive processes. As one of the boxes in this Report documents (Box V.1), evidence from similar episodes in other countries shows that societies that have reached agreements that improve institutionality and governance can go through these profound changes with limited effects on activity and employment. However, if this scenario fails to occur, the evidence points to a much gloomier economic scenario, where even the combined thrusts of monetary and fiscal policy will be insufficient to avert a recession and a persistent rise in unemployment.

Let me now describe our baseline projections.

1. Macroeconomic scenario

As I said at the beginning, the social unrest triggered important changes in the macroeconomic scenario. So far, it has taken its toll on short-term activity. In October, the Imacec recorded an annual fall of 3.4%–which was 4% in the non-mining Imacec component–as a result of various disruptions that affected every economic sector, with facilities damaged or destroyed, difficult commuting for workers and shorter workdays. The steepest falls were observed in retail, manufacturing production and different service lines such as education, transportation, business services and the activity of restaurants and hotels. Compared with the previous month, and after seasonal adjustment, the instantaneous drop-in activity was 6.1% in the non-mining sectors. All this after the economy had grown more in the third quarter than in the first half of the year, in line with our forecasts in the September Report (Figure 1).

For November, the numbers at hand indicate that the economy was affected by the persistent difficulties to operate normally, especially the unrelenting episodes of violent outbursts throughout the country and various impediments for public services and enterprises to function normally. The impact on November's activity reflects also in the *Monthly Entrepreneurs Expectations Index* (IMCE), which saw a sharp downfall in installed capacity use. Manufacturing, meanwhile, fell so much that it hit the levels of the aftermath of the massive earthquake of 2010 (Figure 2).

The need to be better informed on the performance of the economy in recent weeks led us to resort to new sources. Thus, during the third week of November, the Bank conducted a survey among all the companies we interview for our *Business Perceptions Report* (IPN), which are around 1,400. This directory interviews companies in every region and economic sector of the country, with sales volumes and staffing that place them in the categories of small, medium-sized and large companies. Between November 19th and 26th, a total of 343 responses were collected. This survey was complemented with telephone interviews to about 40 companies with significant regional and national representation, by virtue of having qualitative information with which to better interpret the data obtained by the survey. Also, a consultation was carried out among the financial institutions that participate in the IPN— mostly banking offices in the regions other than the capital—as well as participants in the *Bank Lending Survey*.

The results of this survey to businesses are detailed in this Report (Box III.1), depicting the effects that the social crisis has had on various areas where they operate, including activity, employment, investment, prices and lending standards. About November, the responses show that during the month a vast majority of the firms surveyed were affected in their performance, and more firms than not foresee the effects lasting in the next two quarters (Figure 3).

It is also noteworthy that very few firms mentioned that they would increase their staff in 2020, and actually the great majority will maintain or reduce it. Regarding former investment plans for 2020, a very low percentage of those having projects in the pipeline for next year confirmed that they would go ahead as planned. On the contrary, most of the respondents said they are rethinking their plans (Figure 4).

The baseline scenario assumes that activity will see a fall of 2.5% in annual terms in the fourth quarter of this year, concentrated in October and November. December should pick up somewhat, but this is a very uncertain projection. All in all, GDP will accumulate in 2019 around 1%, considerably below our September forecast (2.25% – 2.75%). This projection is based on both consumption and investment posting negative annual changes in the latter part of 2019, with weakness especially concentrated in their tradable components.

The poor performance of the last quarter of 2019 puts a low starting point for the economy in 2020. In fact, although we expect it to resume growth quarter-on-quarter, its annual variation rate will again be negative in the first quarter. So, for the year as a whole, we expect GDP to grow in the 0.5% to 1.5% range. Finally, for 2021 we assume that growth will recover as the outcome of a gradual recovery of the main components of expenditure and production, which, in any case, will be below the 3% to 4% range forecast in the September Report (Table 1). Considering all these differences, the level of GDP by the end of 2021 would underperform our previous forecasts by around 4.5%.

Today's scenario presents a higher-than-usual degree of uncertainty, because of doubts about both how long the disruptions will last, and how the political situation and medium-term fundamentals will unfold. One key factor in the future evolution of the economy will be the confidence of households and businesses and its relationship with the labor market, consumption and investment.

Regarding consumption, various surveys show a sharp deterioration of personal confidence after October 18th. Of particular note is the fall in perceptions about the present and future evolution of the economy, the personal economic situation, employment, and the moment to purchase durable goods, which is now at its lowest level on record (as from March 2002) (Figure 5).

Different sources of information point to the labor market already worsening. As I said, in the Bank's survey a little more than half of the respondents think that their staffs will be reduced somewhat in 2020. Meanwhile, with respect to the same month in 2018, the Labor Directorate's November figures showed an increase of almost 13% in the number of layoffs, most of them on the grounds of "company needs" (Figure 6).

If the historical relationship between labor demand and activity does not change, and no significant supply-side changes occur, the unemployment rate could exceed 10% at the turn of 2020. To the extent that activity improves as foreseen during next year, this rate would be gradually reduced, with the added contribution of expansionary monetary and fiscal policies. At the statistical close of this Report we had no data on wages available for October. Still, we can expect a drop in earnings from sales commissions, lost overtime, missed work shifts and self-employed workers unable to do business as usual.

As for investment, its 2020 forecast is revised substantially, to a 4% drop in the baseline scenario. This responds to a drastic fall in private non-mining investment. This is consistent with the higher uncertainty and the severe erosion of business confidence (as reflected in November's IMCE), the higher costs that firms will face in various scenes (for example, the effects of the peso depreciation on imported machinery), and worsened financial conditions, including the stock market fall and the hikes in corporate rates and spreads (Figure 7).

The negative impacts on investment are partly offset by ongoing large-scale mining investment projects which, according to qualitative information gleaned by the Bank, have been able to avoid the consequences of October 18th. This is not the case of other sectors, where previously committed investment amounts and timetables are being reassessed, as the Bank's survey already discussed can confirm.

The sharp adjustment of private spending will drive a significant reduction in the current account deficit in 2020, to 0.2% of GDP, from an estimated 3% in 2019. This adjustment gains importance when considering that it occurs in circumstances where government savings are reduced. Although to a lesser extent, a higher growth in exports also contributes, favored by the depreciation of the peso in real terms. This Report features a box (Box V.2) describing the dynamics of the current account during the past few years.

The recovery of growth foreseen in 2020 will be aided by monetary policy, which will remain expansionary, a stronger fiscal impulse, the aforesaid recovery of exports and the gradual dissipation of the uncertainty and disruptions that have hit our economy.

On the fiscal front, the Finance Minister made a series of announcements last Monday December 2nd, including an agenda of measures to help reactivate production, with many investment plans and programs to sustain micro, small, and medium-sized enterprises. The resources pledged amount to 5.5 billion US dollars in 2020, of which around 3 billion will be funded with next year's budget. At the same time, a consolidated fiscal program for the period 2020-2022 was released, which involves the resources committed in the recently approved budget plus the expenses of the reactivation plans I just mentioned and social measures that have been approved after the budget, such as a bonus for 1.3 million low-income households. Thus, expenditure would grow 9.8% in real terms compared with last year's budget, the structural deficit for 2020 would rise from the initially proposed 1.4% of GDP to 3% of GDP, and the actual deficit would increase to 4.4% of GDP. The structural deficit will then be reduced at a pace of half a percentage point of GDP in 2021 and again in 2022, to reach 2% of GDP in 2022. This increased deficit will be financed with government assets overseas, mostly denominated in foreign currency, and debt also in foreign currency. With this, more than 11 billion additional US dollars will enter the country, mostly in the first half of the year. This figure is quite similar to the Central Bank's spot sale program (which I will explain in a moment) practically doubling the sale of foreign currency in the early months of 2020. As for gross public debt, the estimates of the Finance Ministry have it that it would stabilize around 38% of GDP towards 2024.

The structural and actual deficit figures planned for 2020 are pretty similar to 2009 figures. This speaks of a fiscal policy that is clearly more expansionary, which is complemented with monetary policy to address a major economic shock, as it did then. This is reinforced by the fact that increased spending will be concentrated in items with the biggest multiplier effect, such as transfers to low-income sectors and investment.

The change in the macroeconomic scenario has also been reflected in the evolution of the domestic financial market. In the days immediately after October 18th, the effects were fairly limited. In the weeks that followed, however, a number of indicators showed a deterioration. The stock market fell, the peso depreciated largely, interest rates and risk perception increased (Figure 8). As can be seen in one of the boxes in this Report (Box II.1), these movements were characterized by high volatility related to internal events. For example, the improvement after an agreement was signed for a New Constitution or, in the opposite direction, intensified episodes of violent outbursts. At the statistical close of this Report, external markets had not been a major source of volatility.

Increased local uncertainty has begun affecting domestic credit conditions. Although interest rates are still low by historical standards, various sources of qualitative information show a tightening of financial conditions. In particular, a special poll under the *Bank Lending Survey* shows a significant drop in the perception of demand for credit, a worsening of delinquency and increased constraints in the supply of loans for persons and enterprises (Figure 9).

This greater degree of uncertainty has given rise to strong movements in financial market prices, which in some cases have gone beyond what the perception of higher country risk would explain. The Bank has responded to these changes by adopting various measures to provide an adequate degree of liquidity to the markets and mitigate volatility of key financial prices. These measures are not intended to set "levels" for certain prices, but rather to avoid excess volatility or abrupt movements hindering the healthy adjustment of the economy and cause concern in markets and the public. In particular, we decided to intervene in the forex market with an amount of up to 20 billion dollars, spanning from December 2nd, 2019 to May 29th, 2020. This will be implemented via a spot sale of dollars for an amount of up to 10 billion US dollars and a sale of hedging instruments until a stock of 10 billion dollars is accumulated. The monetary effects of this measure will be sterilized, so that the provision of liquidity in pesos is consistent with the MPR. In the four days following the announcement of the intervention, the volatility of the exchange rate, which had risen sharply until the previous Thursday, was significantly reduced (Figure 10).

Towards 2021, the baseline scenario forecasts that GDP will grow between 2.5% and 3.5%, based on the assumption that the disruptions that are affecting our economy will fade away over the course of the coming quarters, together with a reduction in the uncertainty that freezes consumption and investment decisions. In this scenario, investment will again outpace GDP growth towards the second half of 2021.

These projections assume that the Chile's economic growth will not receive a significant boost from abroad. The baseline scenario—after the sharp downward revision of September—continues to estimate that world growth in the two-year period 2020-2021 will be among the lowest in the last decade. The projected evolution of the terms of trade is revised down a little from September, with the copper price averaging close to 2.7 dollars per pound in 2020 and 2021 (Table 2).

The baseline scenario foresees that during the second and third quarters of 2020 headline inflation will approach 4%, while core inflation will rise above 3.5% for a while by mid-year, responding mainly to the idiosyncratic depreciation of the peso, which involves higher-than-average pass-through to inflation (Figure 11), as no cushion effects are envisioned in these circumstances, such a decline in the US dollar prices of imported goods that would be associated with a global appreciation of the dollar. Of course, the contraction observed in fourth-quarter GDP and the weaker outlook for 2020 widen the activity gap, partly offsetting the increased inflationary pressures from inflation's tradable component. All in all, the recent idiosyncratic depreciation of our peso limits the scope for monetary policy making, with respect to a situation where the weak currency cuts across all our trading partners.

2. Sensitivities and alternatives to the baseline scenario

There are scenarios in which growth may be within the forecast range but requiring a different MPR path to ensure the convergence of inflation to the target. Bear in mind that a lower-than-expected economic performance is a possibility. It could happen if investment suffers more than we have assumed if, say, the large-scale projects of the mining sector stall and/or housing investment makes a more pronounced adjustment. In such conditions, we could face a bigger increase in unemployment and GDP growing beneath the forecast range, making a recession more likely during 2020—understood as two consecutive quarters posting a negative quarterly variation of GDP.

There are also scenarios where pressures to depreciate the peso intensify, for example due to a resurgence of external uncertainty and/or the local crisis deepens. Although this scenario would also imply a wider activity gap, it would be accompanied by a depreciation that would increase inflationary pressures. Neither can a scenario be ruled out where the sticky labor costs dominate, triggering loss of jobs and increasing inflation, plus a deeper contraction of activity. While it is also possible to have a scenario where uncertainty fades out and confidence is restored faster, we estimate that in the present context it is more likely that we will see weaker activity and a weaker labor market, although it is harder to foretell the consequences on the inflation dynamic, given the opposing effects some of them may have on prices.

We foresee that the nominal monetary policy rate will stay where it is still for some months, which is consistent with the inflation target being achieved, in a context of increased fiscal impulse and forex intervention. Anyway, monetary policy will play a part in the reactivation as it will be, in real terms, below the forecast in the September Report, especially if the comparison is extended over several months. Calibrating the monetary policy will be particularly challenging in the near future and will depend on, among other factors, the evolution of activity, the labor market, the exchange rate and inflation expectations. Other scenarios exist where the economy would perform outside the forecast ranges just discussed. For example, a deeper fall in the fundamentals of consumption and investment would constrain demand and trigger a more persistent period of economic contraction. To the extent that the associated deflationary pressures—in particular the evolution of the activity gap—dominate the inflation dynamic over the policy horizon, this would mean using up an important fraction of the space still open for monetary policy making.

It is also possible for the economy's trend growth to be affected by a more sustained reduction in investment, distortions in the labor market and/or reduced productivity. In such case, although the monetary impulse needed to achieve the inflation target would be smaller, the convergence would occur at a lower level of economic growth and it would take longer. A particularly worrisome scenario could form if regulatory changes drive labor costs significantly above the increase in productivity, in a context of economic weakness. While this could cause a substantial rise in unemployment and affect economic growth, the accompanying increase in inflationary pressures would undermine the countercyclical role of monetary policy.

3. Final thoughts

The social crisis in our country has posed new and important challenges for all of us Chileans. We in the public sphere are front-line responsible for generating responses from each one of our areas of competence, to help overcome the complex moment afflicting our country, minimizing the costs for the population.

In what concerns the Central Bank of Chile, in the past few weeks we have acted in practically every front of our competence. Complying with our legal mandate to safeguard the stability of our currency and the normal functioning of internal and external payments, we have taken a number of measures to provide liquidity to the markets, and we have initiated a substantial forex intervention to facilitate the adjustment of prices and bring down the volatility of the exchange rate, avoiding further effects on activity, employment and inflation.

Typically, in these decisions what is striking are the instruments, the operating design, the resources involved. But we must also emphasize the big challenge that implementing them poses, which requires deep knowledge of the financial market, extracting information in real time, designing tools that will guarantee efficiency and will safeguard the Bank's net worth and performing the ensuing operations in the markets.

We have also helped to safeguard the normal operation of financial infrastructures and payment systems, which have functioned smoothly. One issue of special concern in the early days of the social outbreak was the retail payment system, which saw some destroyed bank branches, vandalized ATMs, a situation that has been almost left behind thanks to coordination with the *Financial Markets Commission* (CMF), banks and securities transport firms. Electronic payment means, meanwhile, operated normally.

Preparing this Report has entailed important challenges. For a long time, our work had been geared towards assessing the effects of external shocks and the domestic cycle, always within a relatively gradual evolution. Today, however, we are faced with an internal shock that suddenly brought uncertainty in many areas. Therefore, gauging its scope and persistence on economic and financial variables is much more complex. This has posed a major challenge to us in our use of our analytical toolkit, delivering opinions around them and making decisions.

The challenges begin by how to measure the immediate impact of the crisis. A month ago, when the crisis had only been going on for a couple of weeks, the markets' expectations regarding October's activity pointed to a drop that we now see as slight. Even in the second week of November, our *Economic Expectations Survey* pointed to a fall in the Imacec of 0.4% annually, far from the figure we learned of last Monday, a drop of 3.4%.

These contrasting figures show that whenever dramatic shocks hit the economy, with social and political roots, episodes may occur much faster than normal, while statistical regularities and traditional data sources may lose value. As a matter of fact, our anticipating of this Report's publication was intended to fill some of these gaps, so as not to delay the delivery of information that the public, the authorities, and the markets need. With this in mind we have supplemented our traditional analysis with new data sources and references to other experiences of social disruption. This is particularly important because we not only must have a diagnosis of what is happening today, but we must also make projections in the midst of a phenomenon that has no precedent in Chilean history.

In this way, the Bank has made every effort to generate additional information, review and enrich its forecasting models, its analysis and capacity to deliver appropriate judgments and timely decisions. We have built on top of projects in progress, access and use of microdata bases and market intelligence that form part of our strategic plan. In this task we have also been helped by the greater knowledge we have acquired on the particulars of the labor market, which is part of the same strategy. However, all these efforts and initiatives fall short when it comes to clearing the enormous uncertainty that dominates the current moment, which will only increase if the abnormal situation the country is suffering is prolonged.

The combination of monetary and fiscal policy that has been developing lends important support to the stabilization of the economy, similar to the response to the *Global Financial Crisis* of 2008-09. But it is obvious that for as long as the underlying uncertainty is resolved, the burden on the economy, and especially on the people, will continue to rise. Our baseline scenario has projections that, if materialized, will drive the level of output—and hence the level of income and wealth of every Chilean—to be much lower than we thought just three months ago. But if the situation continues where the economy cannot operate in proper conditions, we may face a scenario where employment, income and quality of life are hit even harder.

For this reason, as we devote our efforts to contribute from our sphere of responsibility to reduce uncertainty, we believe we face two immediate challenges where we will require the support of Congress. The first one is to close as soon as possible the pending issues of political definition. One of the great lessons that this crisis has taught us is the need to generate broad agreements on matters that are relevant to all. In this sense, the agreements on tax reform, the process for a New Constitution and the dispatch of the 2020 budget are good examples of how cooperation in the political world can help reduce uncertainty while providing a medium-term framework for public finances and answers to the population's most pressing problems. Such agreements help not only to alleviate human and social troubles, but also to restore confidence in the institutions.

The second challenge is to be allowed to concentrate all our efforts in the tasks we have been assigned by law: controlling inflation and promoting financial stability. Faced with the possibility of the Central Bank being assigned new tasks, we must not lose sight of the circumstances the country is enduring and the consequent need to have all our resources at our disposal in the pursuit of economic and financial stabilization.

This does not mean that the Bank thinks it has no room for improving its work and contribute, from its sphere of competence, to improve the well-being of the population. I would like to share with you some reflections on this matter.

In the first place, the experience of these weeks of social unrest shows the importance of the Bank's core objectives. Many thought, for example, that after decades of low inflation, it was no longer a concern for the population. However, the fact that the current crisis was triggered by an increase in the subway fare and that the "cost of living" is cited as one of the main causes of citizen anger, shows that it is an issue that remains in full force, or even worse. Indeed, when people talk about the "cost of living" they include many more elements than the items in the average consumer basket, noting some particularly sensitive prices such as financial costs, indebtedness and income. We believe that these elements confirm the importance of maintaining our firm commitment with price stability, because the sensitivity of the population to high inflation may actually be stronger than it was in the past, when it was part of their day-to-day lives.

Likewise, the fact that it has been 38 years since the last financial crisis does not mean that financial stability is no longer relevant for individuals. People standing in line at the ATMs in the first weeks of the crisis attest to how important it is to have cash in hand, especially in uncertain times. Also evident is the importance of having a healthy financial system, that provides adequate services to the public. We have insisted time and again on the importance of maintaining a sense of urgency with respect to reforms that allow for good monitoring of the households' debt burden. The volatile behavior of some financial prices—exchange rate included—also calls our attention to the frictions and non-linearities that may arise in the markets when exposed to sudden shifts in risk perceptions. These are particularly relevant if we consider that the normal operation of the financial system is key for all kinds of transactions between individuals, businesses and government function properly.

A second lesson has to do with the importance of having a sense of urgency about reforms that benefit people and prevent abuse. A few weeks ago we reminded this Commission that the Bank has been insisting for years on the need to establish a unified registry of debts, in a context where overborrowing in important segments of the population has relied on the system's unawareness of the true level of debt with different creditors. We can confirm now that the Executive will soon send a new bill on this topic for discussion in the National Congress.

Thirdly, we must stress the importance of looking beyond aggregate figures and broad averages. Although this is the ecosystem that macro-economists inhabit, by doing so one may lose sight of the reality of large sectors of the population and crucial aspects of economic agents' behavior. Luckily, the Central Bank has been developing for several years an agenda to obtain and use microdata, which allows to achieve much more granularity in the analysis. Thus, the data bases we were utilizing to better understand the behavior of the labor market for macroeconomic analysis, have been key to identify and quantify the chain effects of the problems that some firms hardest-hit by the attacks on their infrastructure and related shutdowns of recent weeks.

Lesson number four is that the space accumulated in periods of abundance and calm must be available for use during a crisis. For many years policy makers stressed the importance of this space, hoarding and protecting them, while stress tests evaluated their relevance in more complex scenarios. Many saw in this as excessive zeal or orthodoxy. Now that a true crisis hit home, leeway has been invaluable in cushioning the impact of the crisis and articulating response measures. During this period, the Central Bank and the Finance Ministry have given proof of their determination to use these resources, which will help to lessen the impact of this unprecedented shock.

Last, but not least, an important lesson learned during this period is the need to explain, educate, listen and stand in other people's shoes in order to gain the public's trust that is so crucial during convoluted times. From this same perspective, it is important to appreciate other disciplines to understand phenomena that, despite having an economic expression, originate in other dimensions of a country's life. A few months back, before the social outburst, I said that I did not see economists as the owners of the truth, but that did not prevent them from making a contribution to public policy decisions. This interdisciplinary dialogue and cooperation based on the humility and recognition of a shared task is especially important in Chile in the present time. The Central Bank will do everything in its power to contribute to its construction.

Senators present,

This Report is, without a doubt, the most difficult one in the inflation-targeting era. Difficult to prepare, difficult because of the dimensions of uncertainty, and difficult to communicate. We are aware that we are not bearers of good news, but we are convinced that today the country needs its Central Bank to speak frankly, honestly and with technical grounding, because it is from this base that it will be able to address the ongoing social unrest. The projections in this Report talk of activity downfall, massive economic losses in some sectors, destruction of jobs and enormous challenges for the recovery, especially if we want it to proceed without further pressuring the cost of living and the well-being of the population.

It is not in our nature to give false hope, or lead people to believe that the solutions will come easy. Neither can we give the idea that there are unlimited resources and tools for the economy and the people to go through these turbulences unscathed. As we noted earlier, we policy makers and Chileans in general will have to work hard to avoid the most dire and persistent consequences on unemployment and inflation, which as we know would also result in increased inequality.

At this moment, one day of delay has a huge cost, and we must be able to look at the big picture where, faced with each discussion we must ask ourselves not only what can we gain, but also what can we lose, especially when those who can lose the most are our fellow citizens whose dissatisfaction and demands have awakened these days. Suffice it to say that, should unemployment approach 10% and inflation 6%—

twice the Central Bank’s target—the Gini coefficient, which measures inequality in the income distribution, would go back 27 years, as those were the numbers in the early 1990s.

In short, ladies and gentlemen, we are certainly facing an enormous challenge. Our economic policy framework has allowed us to react appropriately, maintaining a highly expansionary monetary policy that provides the necessary space for fiscal policy to take resolute action. At the same time, we have adopted measures, like intervening the exchange rate, to prevent financial markets from experiencing stressful episodes that would affect financial conditions for the rest of the economy. However, commitment, cooperation and concrete actions are still required to ensure that the country can overcome this crisis and use it as an opportunity to improve the lives of all its inhabitants. The last few hours have been encouraging in terms of the progress of important initiatives, reaffirming respect for the Constitution. We believe that this Commission, where the first of the cross-cutting agreements was reached in response to the crisis, is a particularly appropriate place to reaffirm the value of that commitment to the country, of which the Central Bank of Chile is also part.

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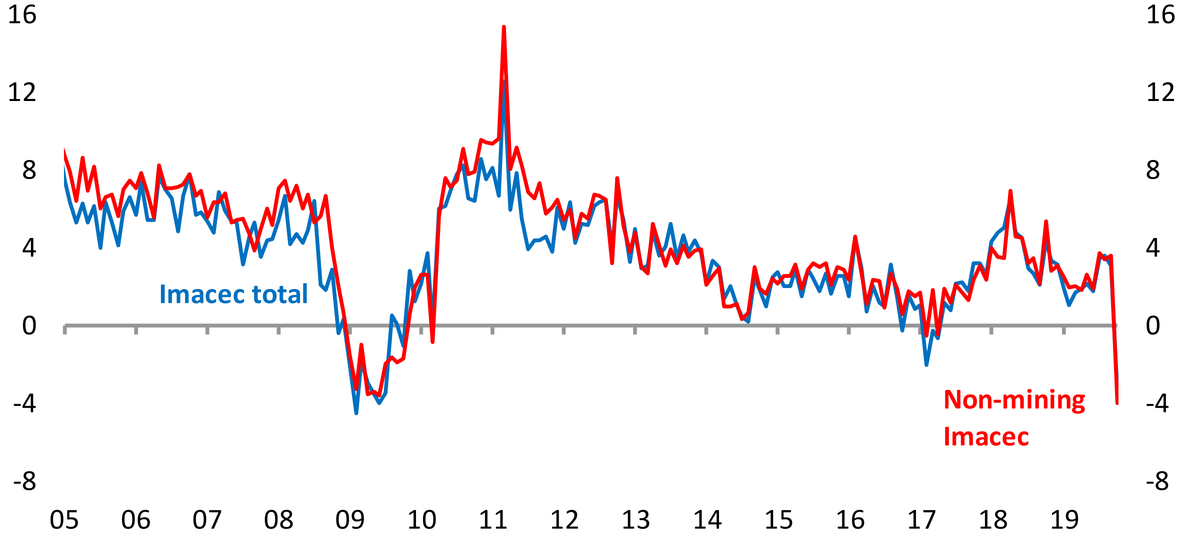
Figure 1

Imacec

(annual change, percent)

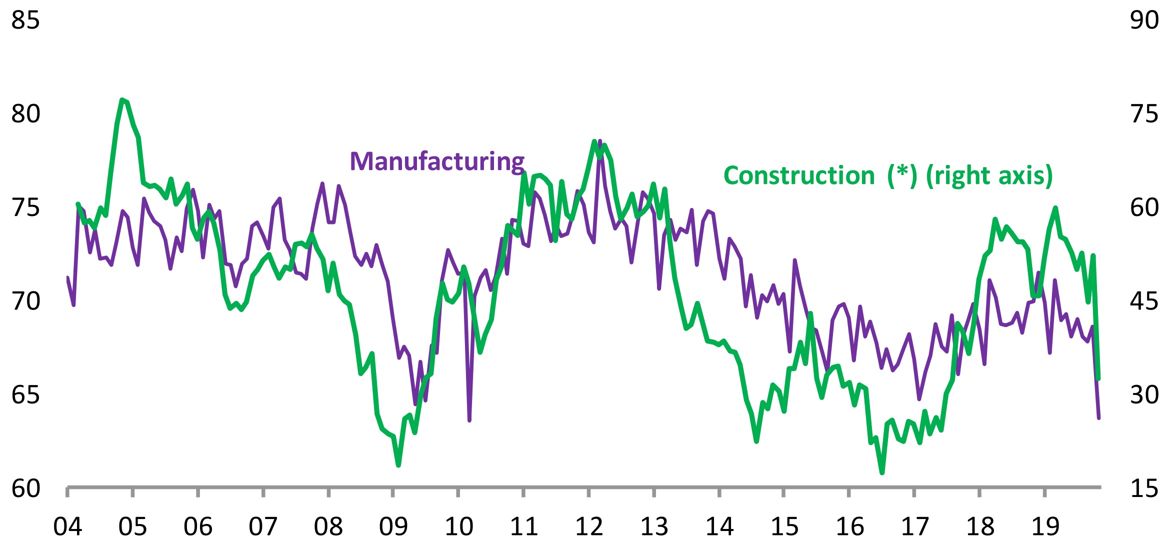


Source: Central Bank of Chile.

Figure 2

Installed capacity utilization (IMCE)

(percentage of capacity used)



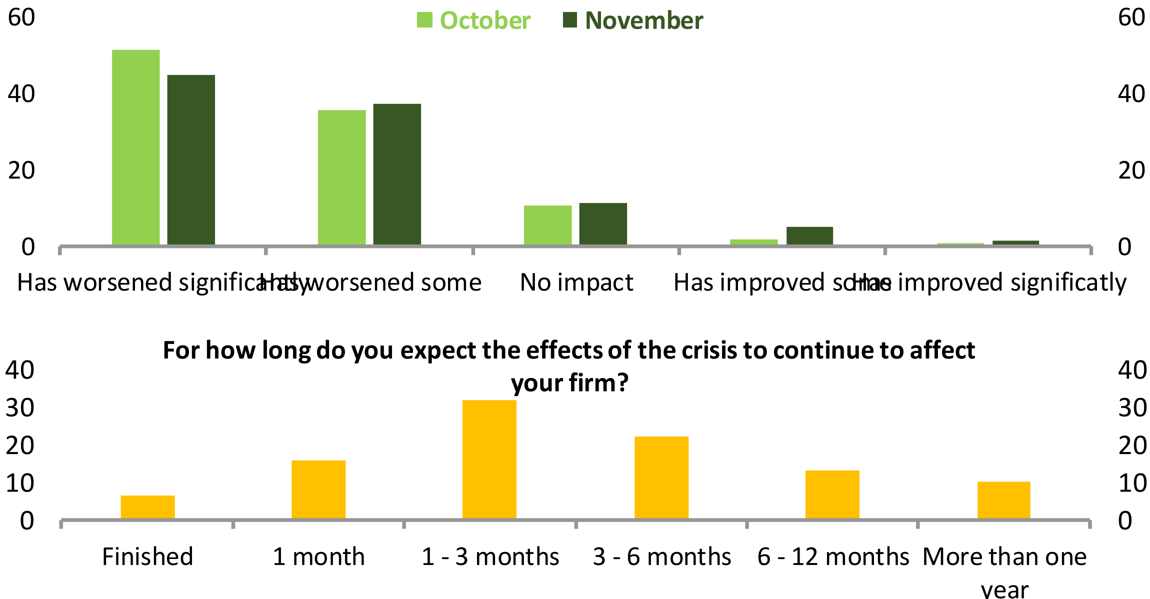
(*) Level of activity expected three years ahead.

Source: ICARE/UAI.

Figure 3

Effects on businesses

(percent)

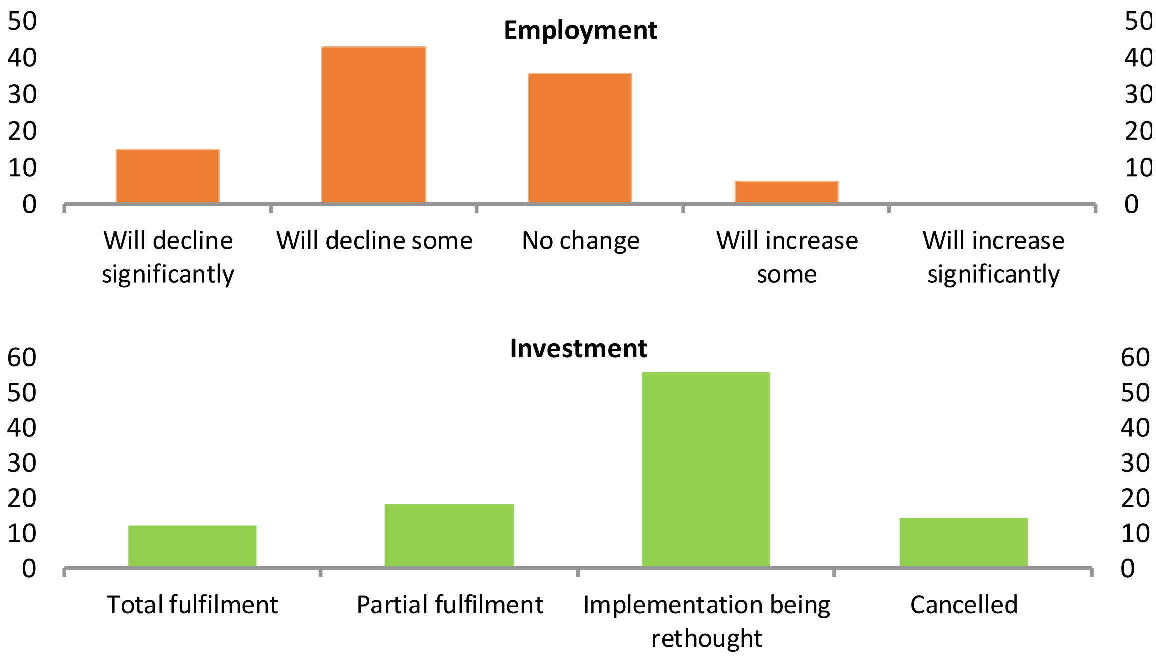


Source: Central Bank of Chile.

Figure 4

Effects on employment and investment during 2020

(percent)

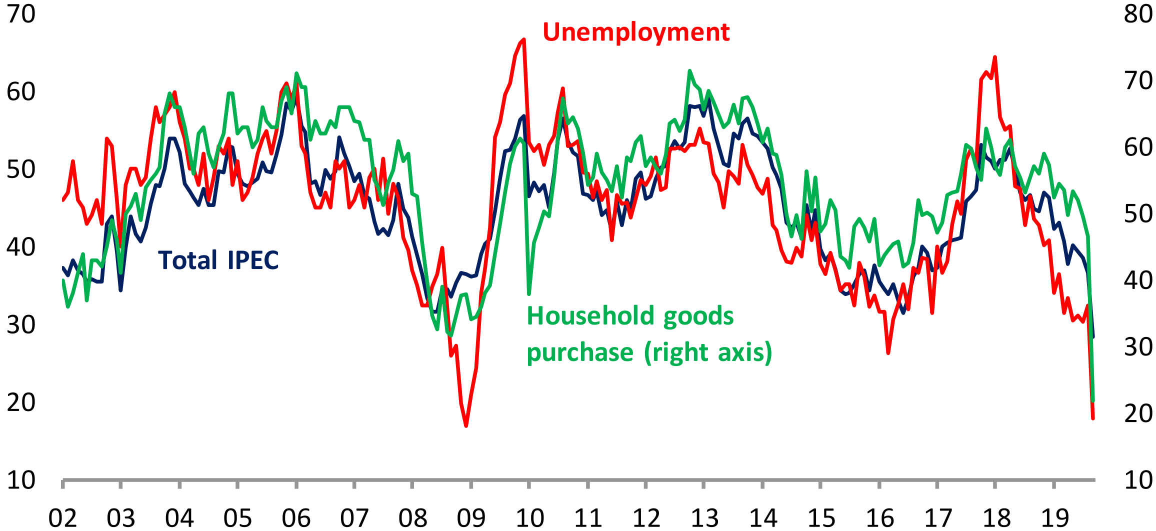


Source: Central Bank of Chile.

Figure 5

Consumer expectations (IPEC) (*)

(index)



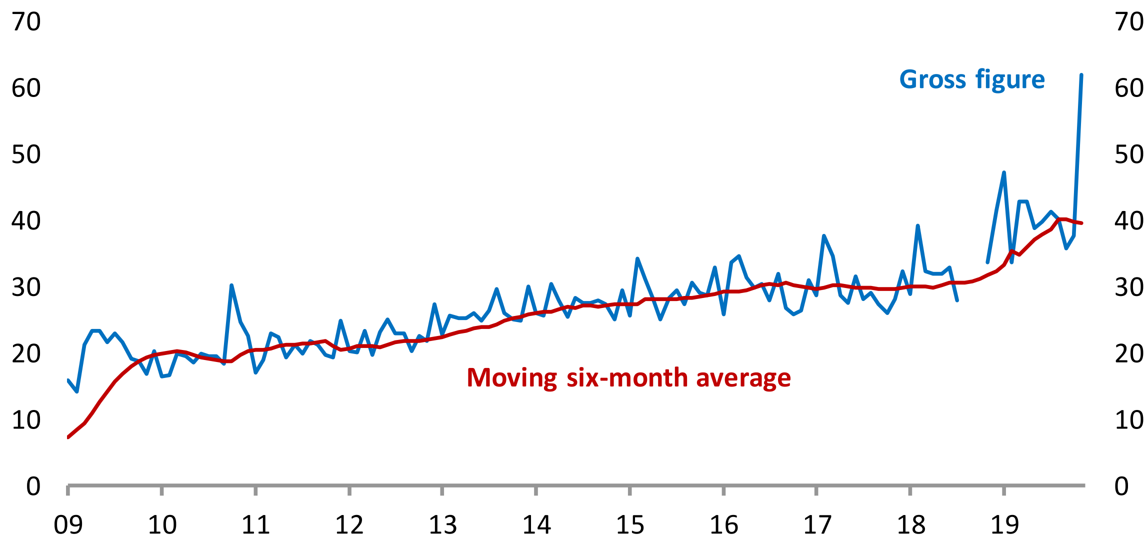
(*) Value above (below) 50 denotes optimism (pessimism).

Source: Adimark.

Figure 6

Job terminations on grounds of company needs (*)

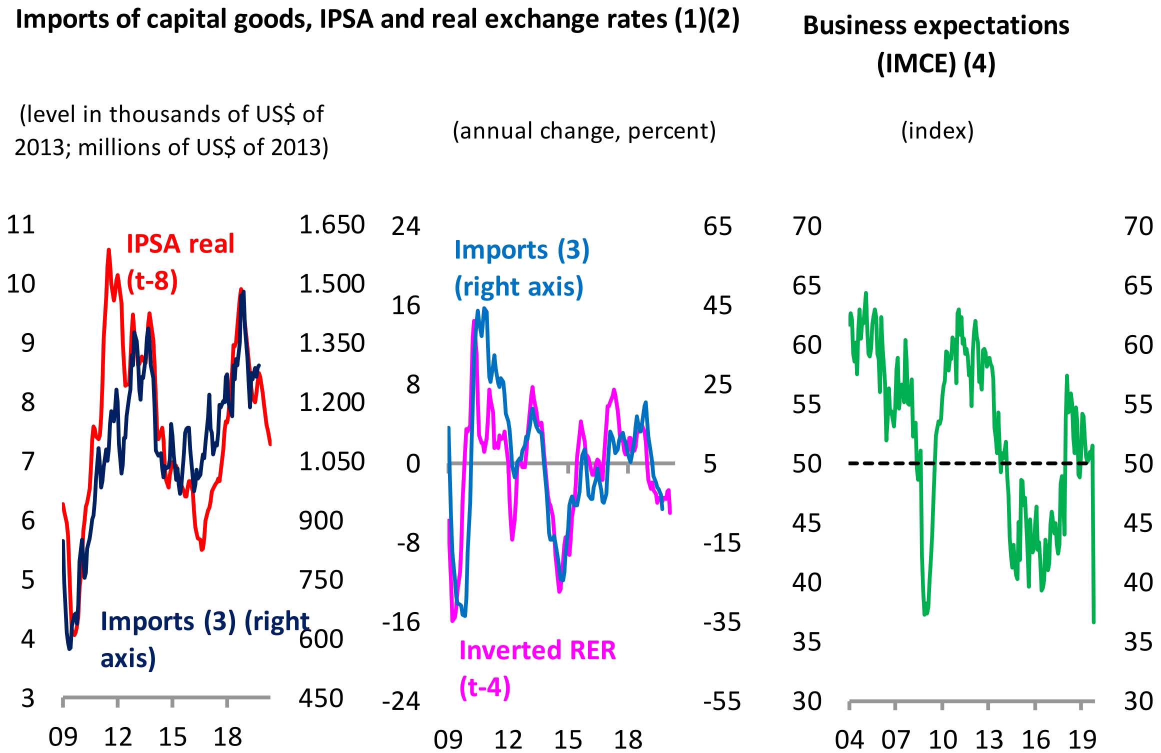
(thousands of contracts)



(*) Excludes executive officers.

Source: Labor Directorate, Ministry of Labor and Social Security.

Figure 7

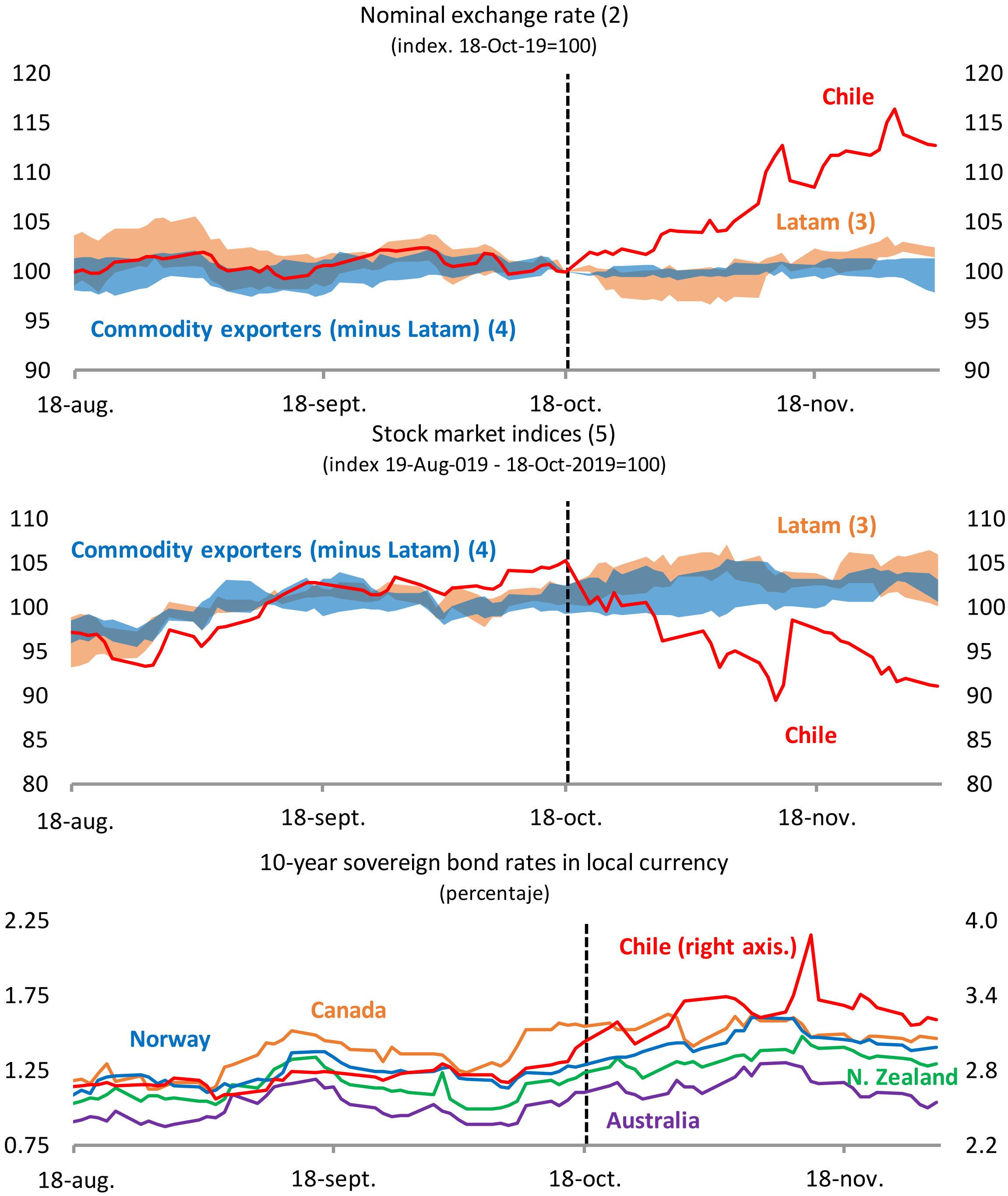


(1) Moving quarterly averages. (2) Series deflated by capital goods imports price index, base 2013=100. Spliced with series base 2008=100 using annual changes. Figure for July 2019 assumes same value as second quarter 2019. (3) Excludes other transport vehicles. (4) Value above (below) 50 denotes optimism (pessimism).

Sources: Central Bank of Chile, Bloomberg and ICARE/Universidad Adolfo Ibáñez.

Figure 8

Financial indicators (1)



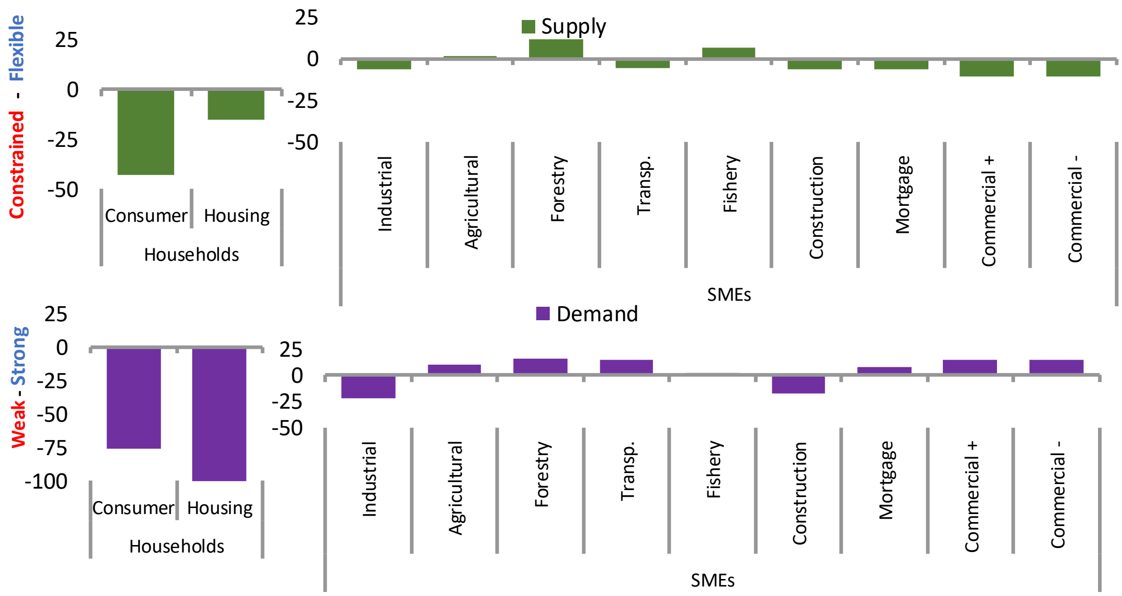
(1) Dashed vertical line marks 18 October 2019. (2) Use nominal exchange rate at closing of each day. Colored areas show range of normalized series for a group of countries. (3) Latam includes Brazil, Colombia, Mexico and Peru. (4) Commodity exporters (minus Latam) include Canada, Australia, New Zealand and Norway. (5) Uses daily closing value of each stock index. Colored area shows range of normalized series for a group of countries.

Sources: Central Bank of Chile and Bloomberg.

Figure 9

Perceptions of credit market 3 months ahead

(index)

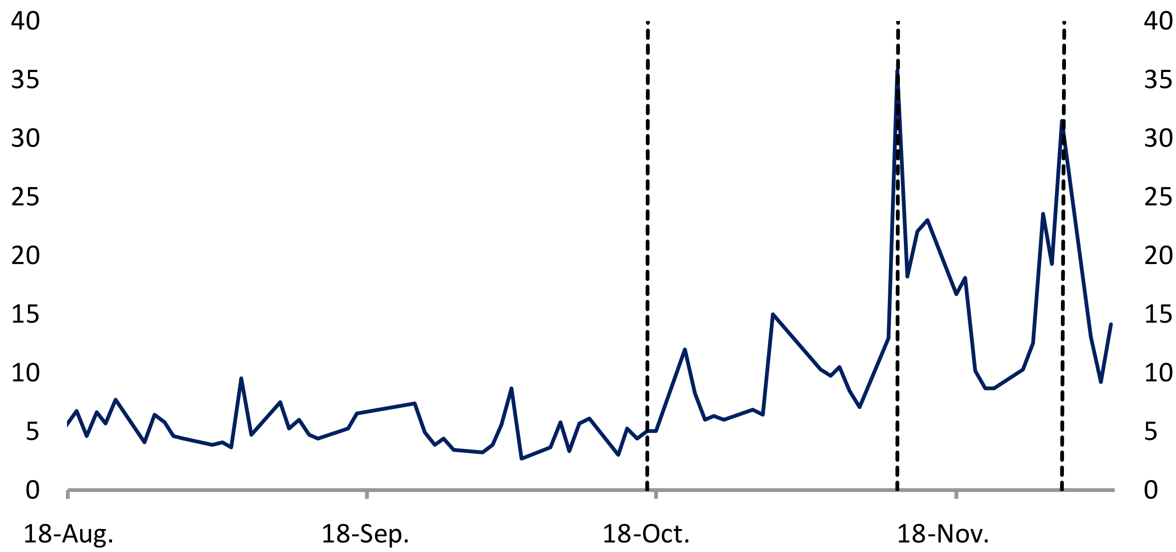


Source: Special poll under Bank Lending Survey, Central Bank of Chile.

Figure 10

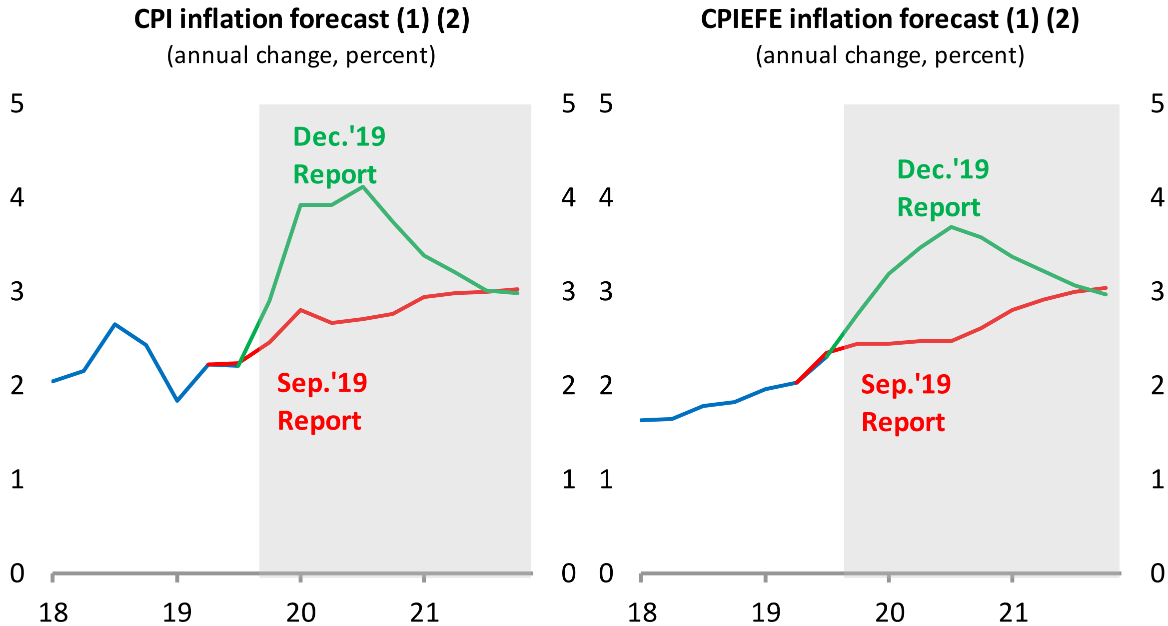
Overnight volatility of nominal exchange rate (1) (2)

(Chilean pesos)



(1) Calculated as the difference between max and min daily prices. (2) Left dashed vertical line marks social outbreak (18 October). Middle vertical line marks first announcement of Central Bank liquidity measures (13 November). Right dashed vertical line marks Central Bank forex intervention (2 December). Source: Bloomberg.

Figure 11



(1) For 2018, line shows annual change from splicing the 2013=100 base series with monthly changes in 2018=100 basket as from February 2018. See box IV.1 in Monetary Policy Report of March 2019. (2) Gray area, as from the fourth quarter 2019, shows forecast.

Table 1
Domestic scenario
(annual change, percent)

	2018	2019 (f) Sep.19 Report	2019 (f) Dec.'19 Report	2020 (f) Sep.19 Report	2020 (f) Dec.'19 Report	2021 (f) Sep.19 Report	2021 (f) Dec.'19 Report
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
Demanda interna (sin var. de existencias)	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	5,5
Current account (% of GDP)	-3.1	-3.3	-2.9	-3.1	-0.2	-2,6	-0,8
Gross national savings (% of GDP)	19.6	19.3	19.6	19.9	19.9	20,6	20,1
Nominal gross fixed capital formation (% of GDP)	21.3	21.9	22.0	22.1	21.1	22,1	21

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

Table 2

International baseline scenario assumptions

	2018 (e)	2019 (f)		2020 (f)		2021 (f)	
		Sep.'19 Report	Dec.'19 Report	Sep.'19 Report	Dec.'19 Report	Sep.'19 Report	Dec.'19 Report
Terms of trade	-2.1	-0.9	-1.9	-0.3	-0.2	2.0	1.4
Trading partners' GDP	3.7	3.1	3.1	2.9	2.8	3.1	3.0
World GDP at PPP	3.6	3.1	3.0	2.9	2.8	3.1	3.0
Developed economies' GDP at PPP	2.2	1.6	1.7	1.4	1.3	1.5	1.5
Emerging economies' GDP at PPP	4.8	4.3	4.0	4.1	4.0	4.4	4.2
LME copper price (US$cents/lb)	296	270	270	260	270	270	275
WTI-Brent average oil price (US$/barrel)	68	60	60	55	58	54	55

(e) Estimate except for commodity prices.
(f) Forecast

Source: Central Bank of Chile

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