

# MONETARY POLICY REPORT December 2020

Mario Marcel C.  
Governor

Central Bank of Chile, 10 December 2020



## Introduction

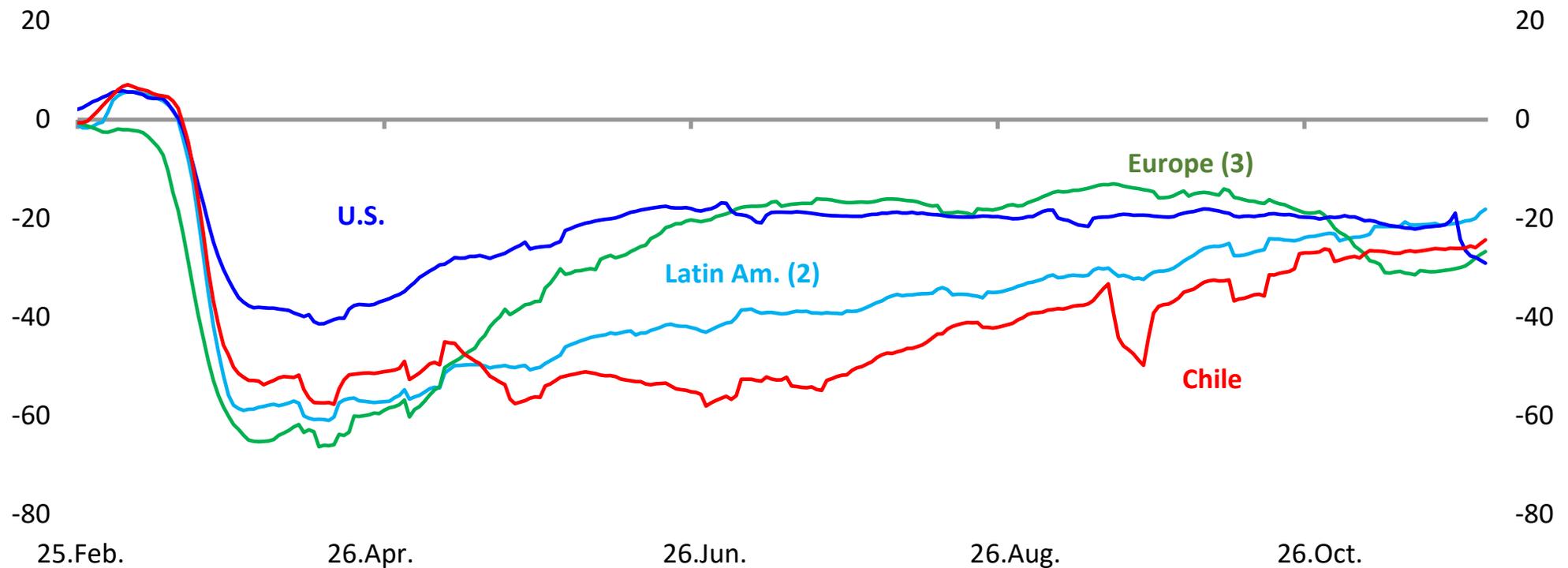
- *Our economy has continued to recover as it gradually opens up, and many people have been returning to their jobs. Since June the economy has undone about half of the decline of the preceding four months. The activities most affected by the social distancing remain far behind.*
- *Consumption has received a major boost from the recovering employment, government subsidies and the withdrawal of pension savings. Investment, on the other hand, faces difficulties and uncertainty in its recovery. The improvements of our trading partners have revitalized our exports.*
- *After falling between 6.25% and 5.75% in 2020, the economy is expected to grow in the range of 5.5% to 6.5% in 2021. A universal vaccination could further improve the outlook, but in the meantime, new outbreaks of Covid-19 could force a step back in the plan to open up the communes.*
- *Economic policy must support the recovery, adapting to the new needs of households and businesses at this stage. Monetary policy will remain highly expansionary for much of the next two years and the Central Bank will be ready to act in case of threats to financial stability.*



*In recent months, the population's mobility has improved and economies have been reopening. In Chile, the increase in mobility has been slow compared with other countries.*

## Mobility (1)

(moving seven-day average)



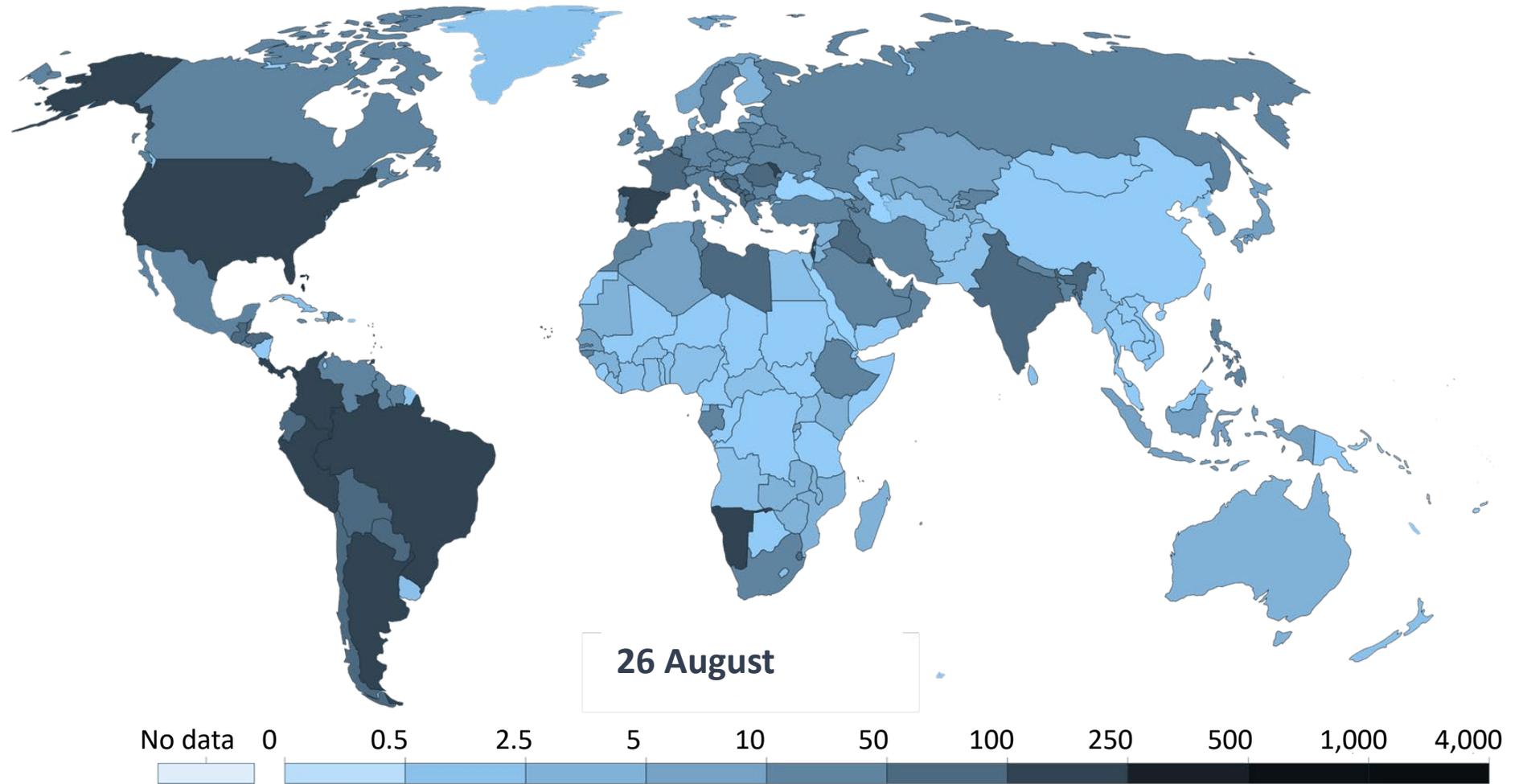
(1) Average of the retail and leisure, supermarkets and pharmacies, transport stations and workplaces categories. (2) Simple average of Argentina, Brazil, Colombia, Mexico and Peru. (3) Simple average of France, Germany, Italy, Spain, and the United Kingdom.

Source: Covid-19 Commune Mobility Reports, Google.



*This, in the midst of new sprouts of Covid-19 in several economies.*

**New daily confirmed Covid-19 cases**  
(number of persons per million inhabitants)

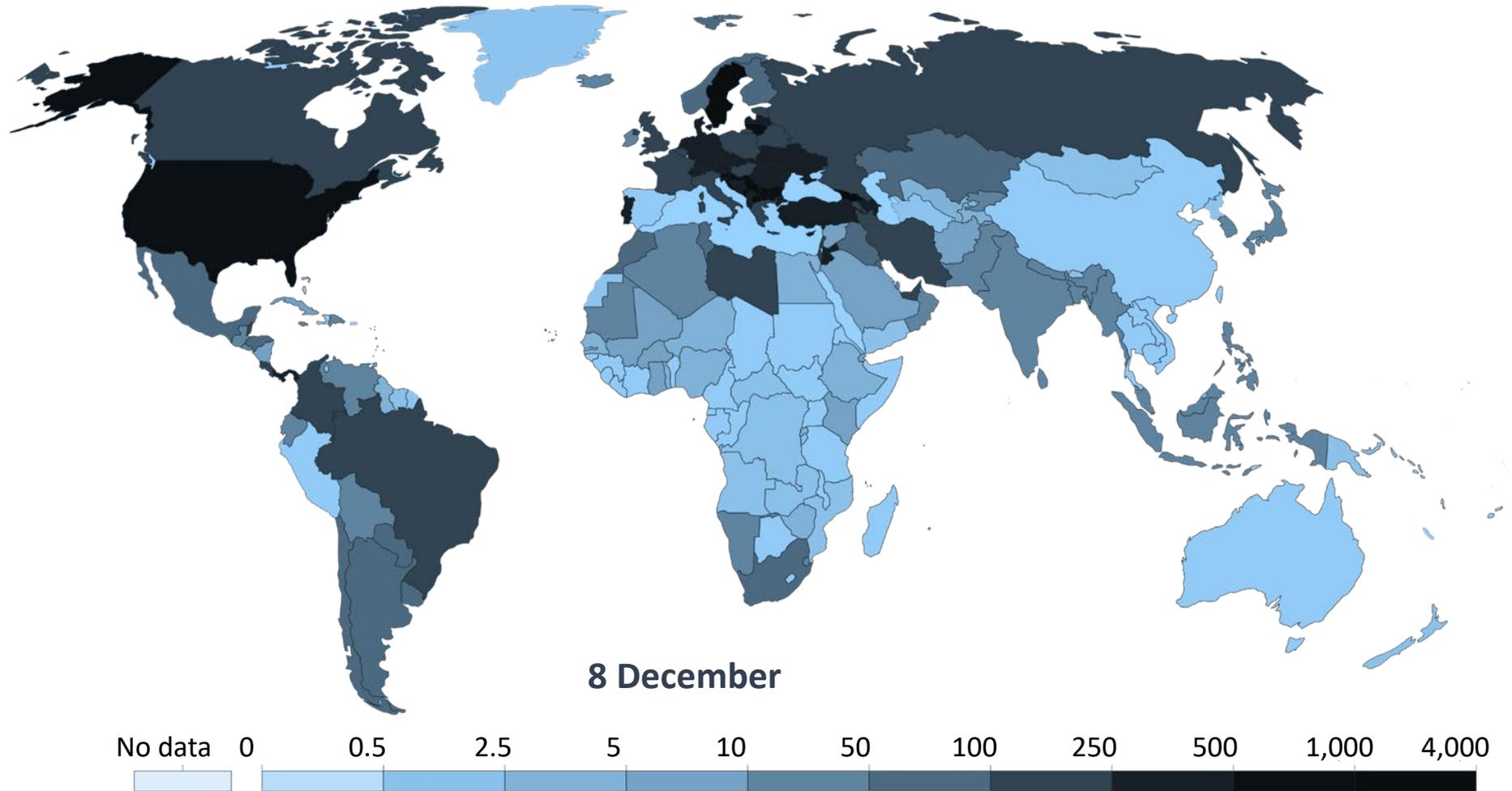


Source: European Centre for Disease Prevention and Control.



*...so new peaks of infections have been reported in a number of countries in Europe and the United States*

**New daily confirmed Covid-19 cases**  
(number of persons per million inhabitants)



Source: European Centre for Disease Prevention and Control.



*At the same time, successful results have been reported in the development of a vaccine against the disease.*

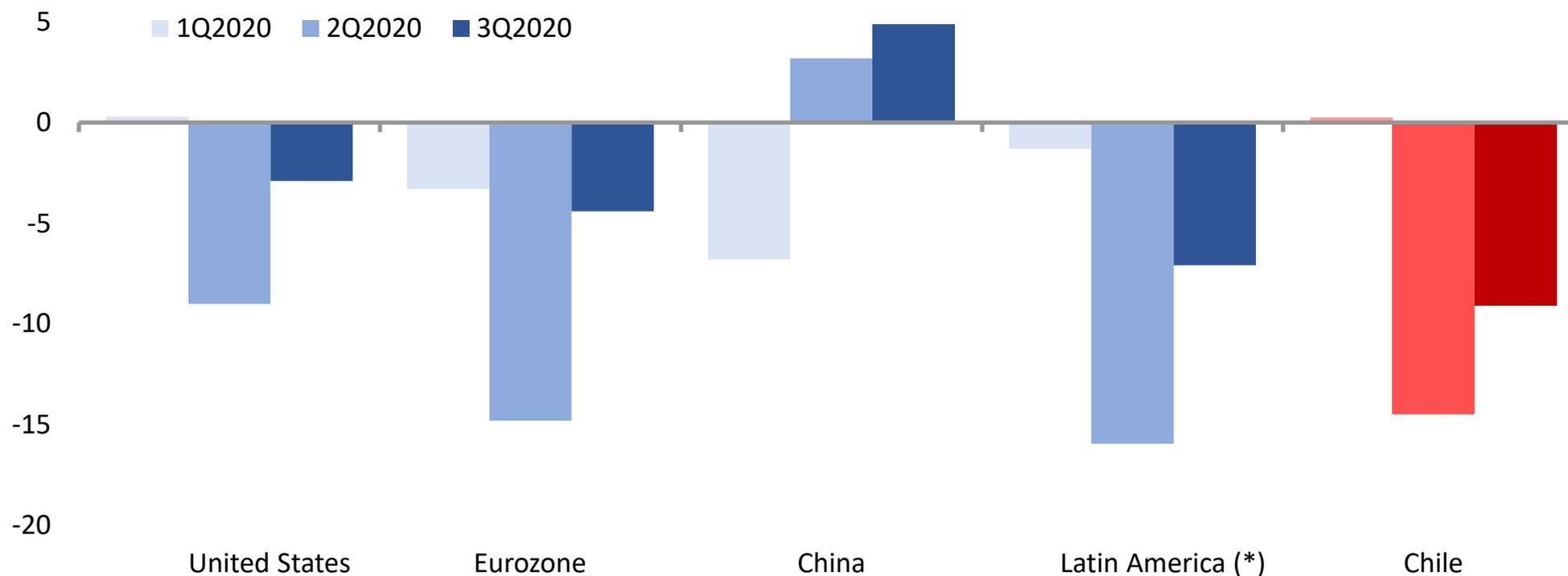


- ➔ Sanitary authorities in Chile and elsewhere have announced that the vaccination process will begin shortly.
- ➔ During 2021 some countries, mainly in the developed world, could succeed in having a large part of their population vaccinated and achieving herd immunity.
- ➔ The effects of a vaccination on activity will be more visible towards 2022.



*In this context, global activity has continued to recover, albeit unevenly across countries. China leads these advances.*

### GDP, selected economies (annual change, percent)



(\*) Weighted average at PPP of Argentina, Brazil, Colombia, Mexico and Peru using figures from the World Economic Outlook (WEO, October 2020). For Argentina, the figure for Q3.2020 is the averaged annual EMAE variations of July, August and September. For Brazil, it includes third quarter GDP published on 3/December/2020.

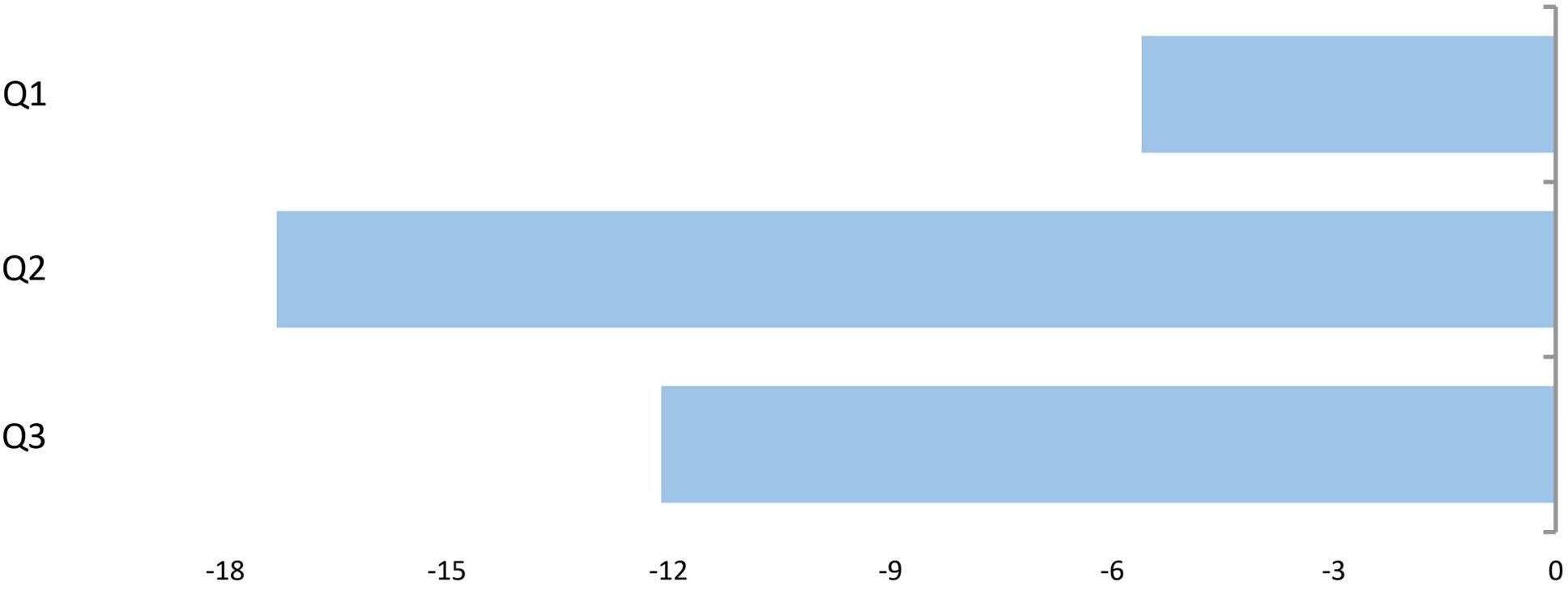
Sources: Central Bank of Chile, Bloomberg and the IMF.



*The reopening of businesses has also helped to reverse the deterioration in labor indicators.*

**Hours worked in 2020 globally**

(variation with respect to fourth quarter 2019, percent)

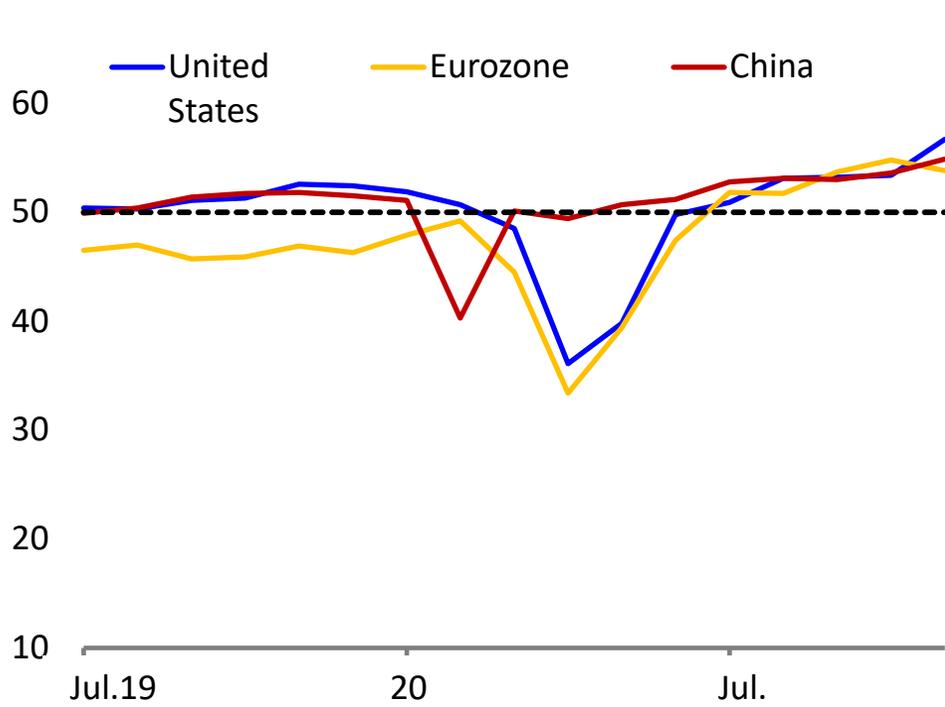


Source: International Labor Organization.

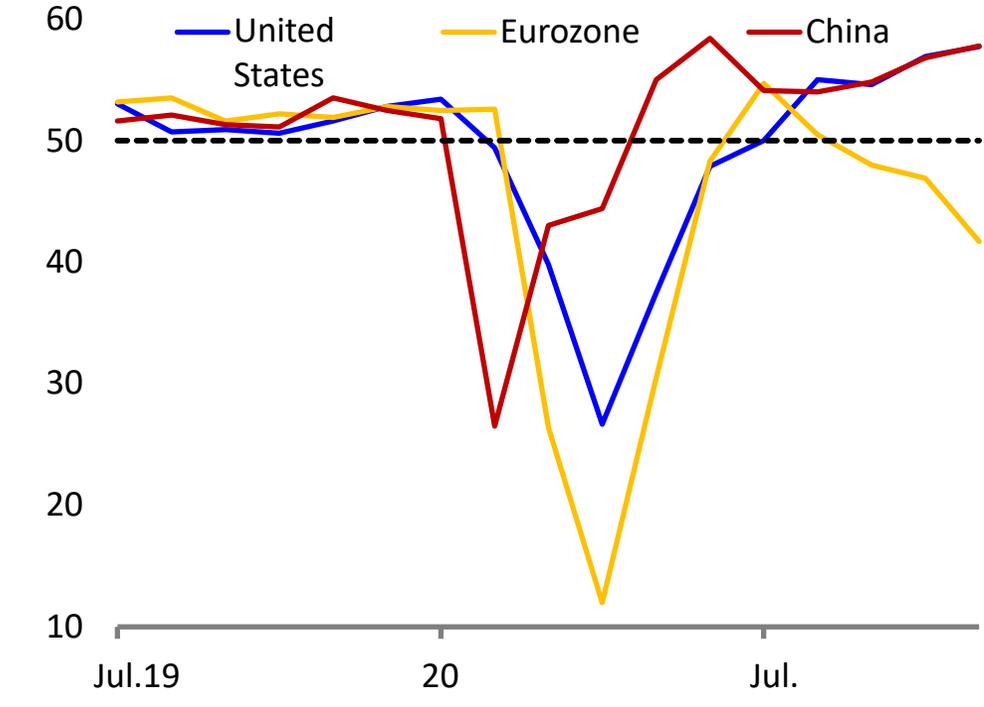


The upturn has been heterogeneous across economic sectors, with weaker indicators for suppliers of services than of goods. On this front, China's recovery also deserves special mention.

### PMI Manufacturing (\*) (index)



### PMI Services (\*) (index)



(\*) A value over (under) 50 indicates optimism (pessimism).

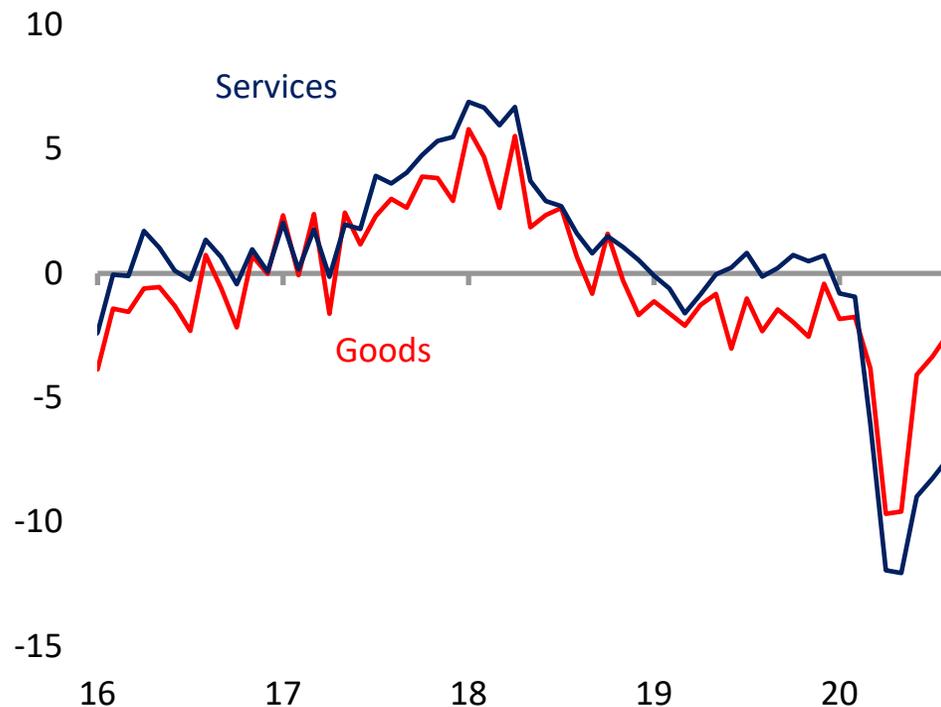
Source: Bloomberg.



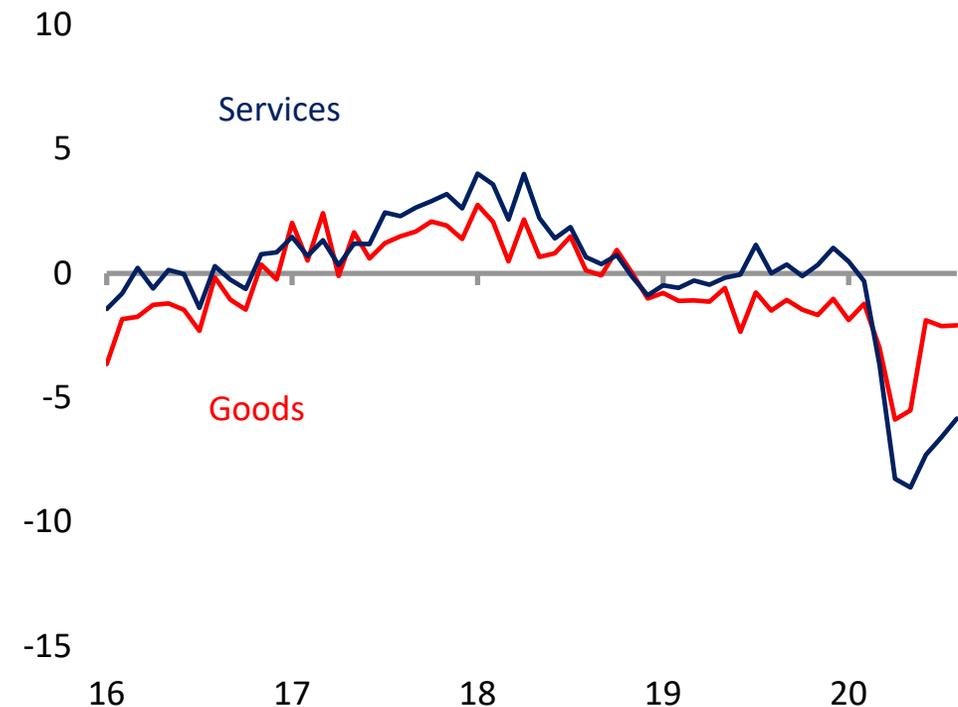
*The upturn in consumption and production of goods has given a boost to international trade, especially favoring exporters of commodities and consumer goods.*

### Nominal exports (annual change, percent)

#### Developed economies (1)



#### Emerging economies (2)



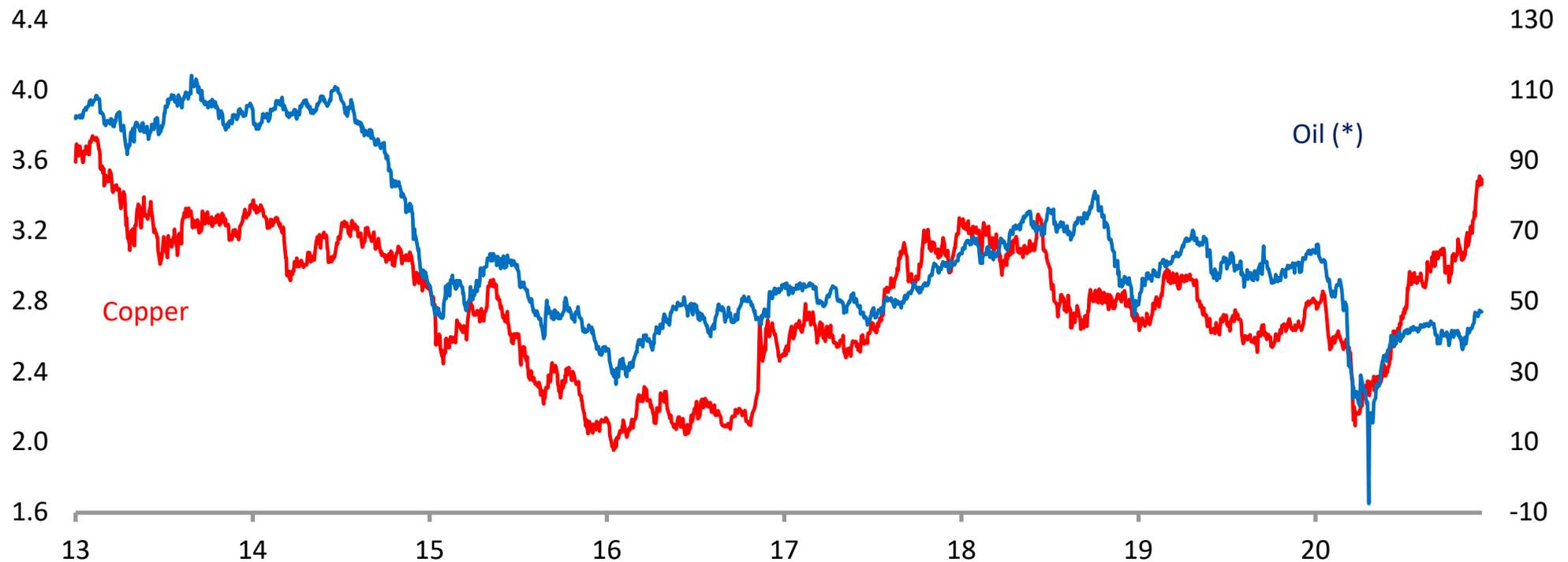
(1) Includes Australia, Belgium, Canada, Czech Rep., Denmark, Estonia, Finland, France, Germany, Greece, Italy, Japan, Korea, Latvia, Lithuania, Luxembourg, Malta, Portugal, Slovakia, Slovenia, Sweden, United Kingdom, and the United States. (2) Includes Belarus, Brazil, Bulgaria, China, Hungary, India,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



*In this context, commodity prices have continued to rise in the past few months. The copper price has consolidated in levels above US\$3 per pound.*

## Commodity prices

(US\$ per pound; US\$ per barrel)



(\*) Simple average of the Brent and WTI crude oil prices per barrel.

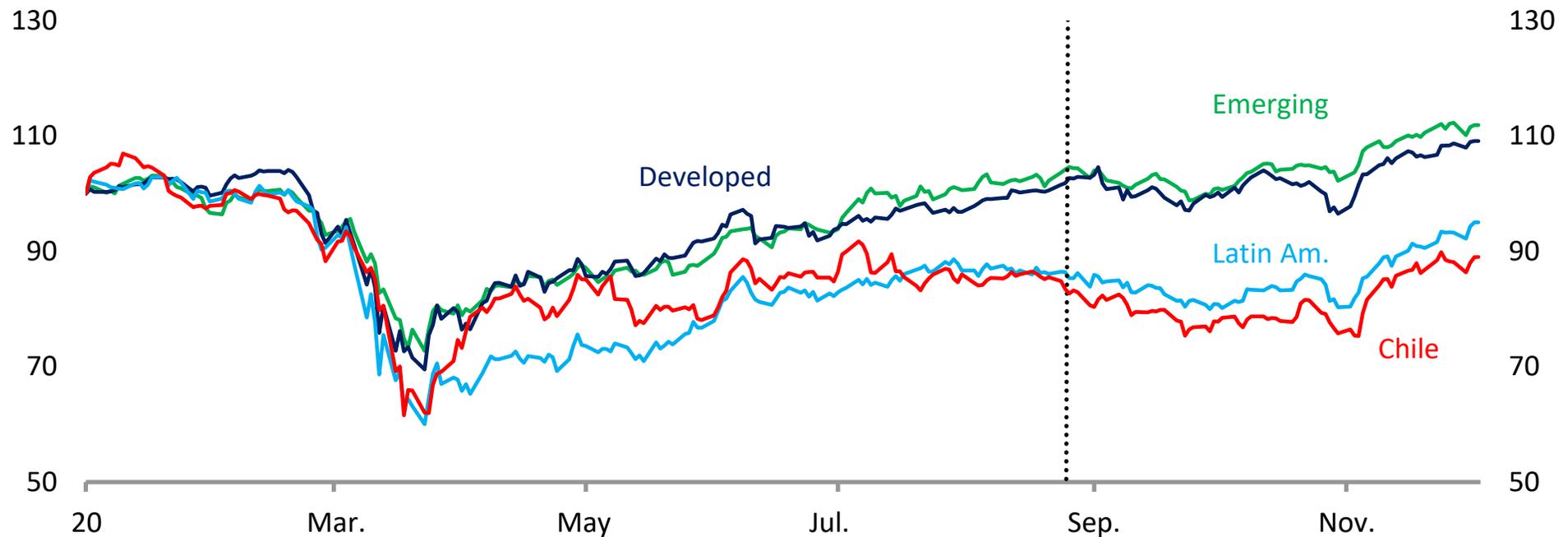
Source: Bloomberg.



*The external financial markets maintain a favorable tone, in the midst of abundant global liquidity, and has been boosted in recent weeks by optimism about an upcoming vaccine.*

## 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, IPSA stock index. (2) Vertical line marks the statistical cutoff date for the June 2020 Monetary Policy Report.

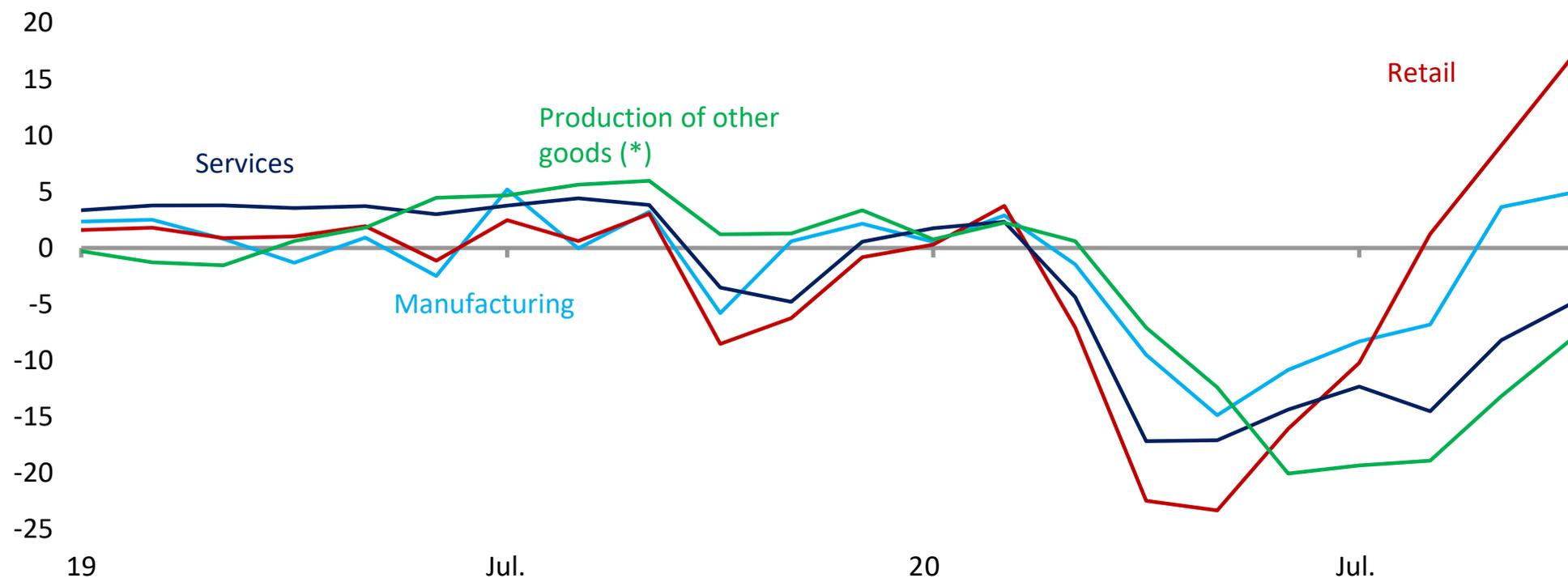
Source: Bloomberg.



Chile has followed the global trends in pandemic management and economic performance, showing heterogeneous progress across sectors and the recovery, in October, has been slower than expected.

## Imacec

(annual change, percent)



(\*) Considers agricultural and forestry activities, fishery, EGW and waste management, and construction.

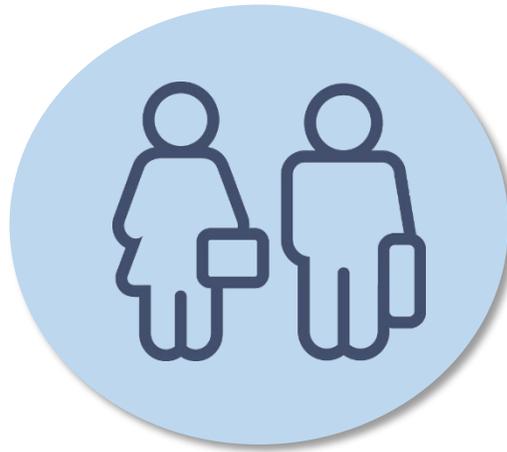
Source: Central Bank of Chile.



*This has played a role in the recovery of the labor market, where significant gaps remain.*



Around one third of the jobs lost during the pandemic have been recovered



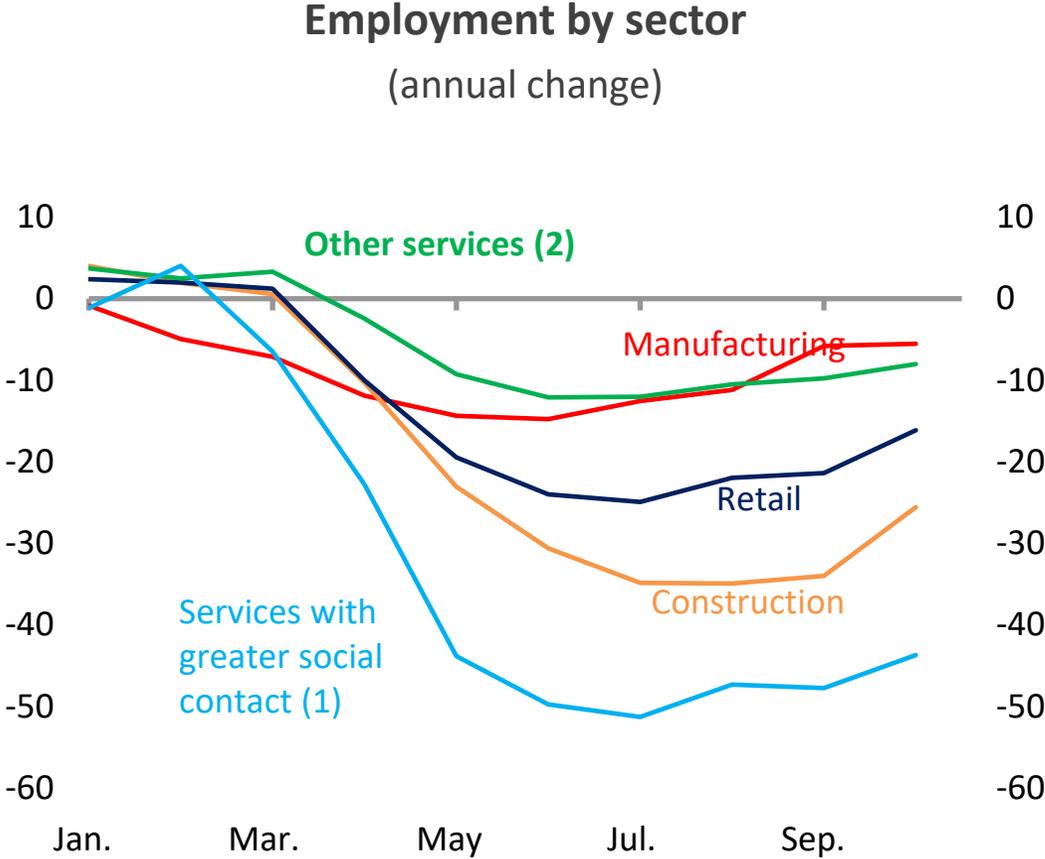
As of October, about 900,000 jobs were suspended, from a peak of slightly more than 1.3 million in July



Real labor income showing positive evolution



The improvement in employment has also been heterogeneous. In wholesale and retail trade, the upturn has not been as dynamic as it has been on the activity side of the sector.



(1) Includes lodging and meal service activities, and arts, entertainment and recreation. (2) Includes financial and insurance activities; real estate; professional, scientific and technical activities; extraterritorial organizations and bodies; administrative and support services; households as employers; human health care and social work; public administration and defense; education; and other service activities. Sources: Central Bank of Chile and National Statistics Institute.

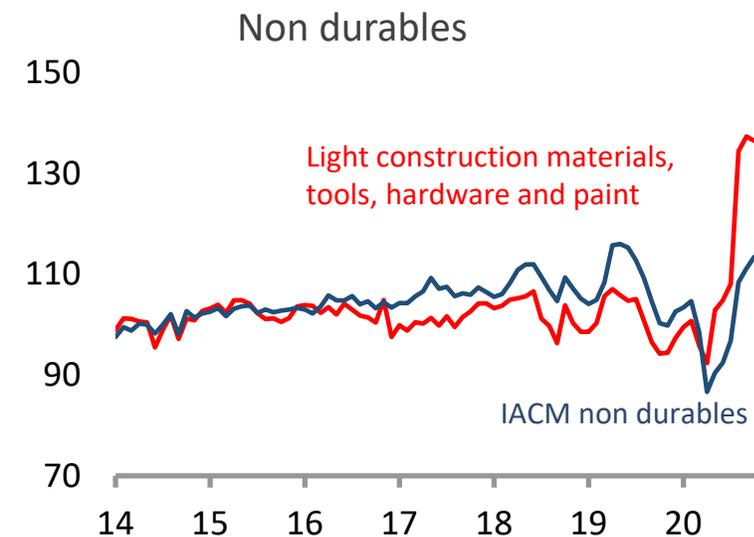
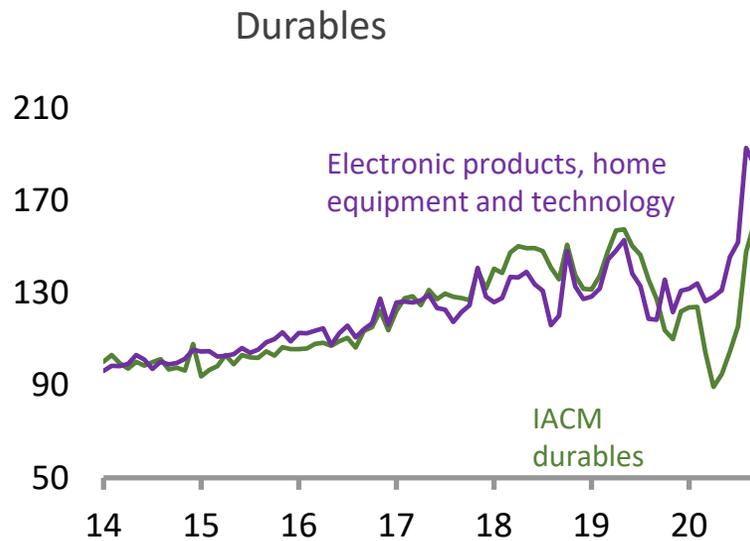


*One important element in the performance of the Chilean economy in recent months has been the withdrawal of pension funds, which has significantly boosted the consumption of goods.*

	First withdrawal	Second withdrawal
Amount (effective/potential)	US\$17 billion	US\$17 billion
Effect on GDP (percentage points)	+/-1.8	+/-1.0

### Retail activity index

(index, 2014 = 100, sasonally-adjusted series)



Source: National Statistics Institute.



*One effect of this increased momentum has been a substantial depletion of wholesale and retail inventories, in the midst of a slow replenishment in the business sector.*



Imports of consumer goods have not matched the dynamism of sales.

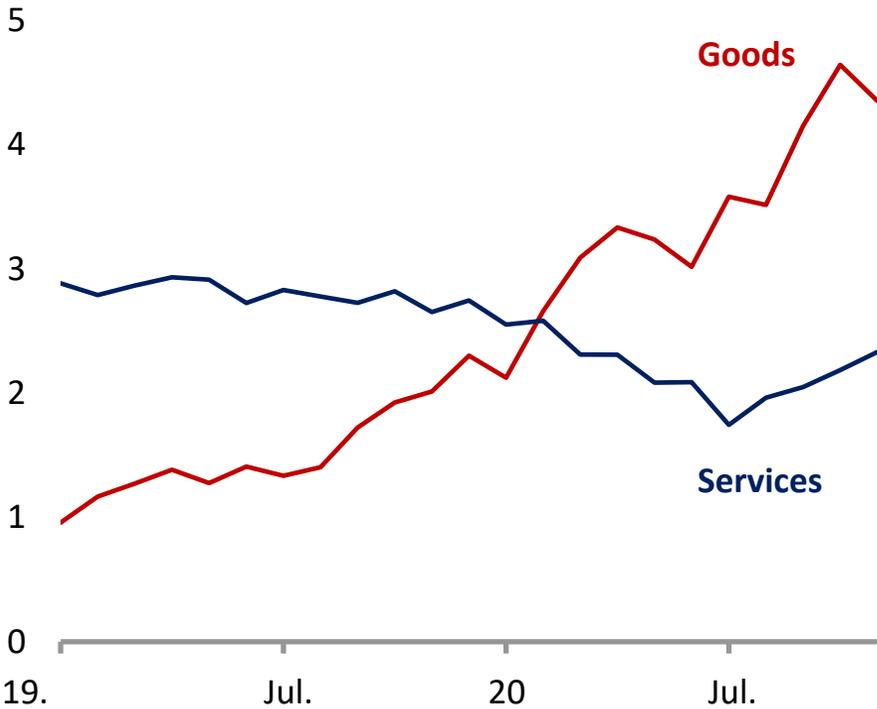
Some products, including hardware materials, home equipment, and automobiles, have even seen stockouts.



*This exerted pressure on the prices of some lines of goods, which played a role in the surprisingly high CPI variation in September and October. Yet this was partially offset in November, once the transitory effect of the first withdrawal of pension savings had faded out.*

### CPI w/o volatiles

(annual change, percent)



Annual inflation in  
November  
**2.7%**

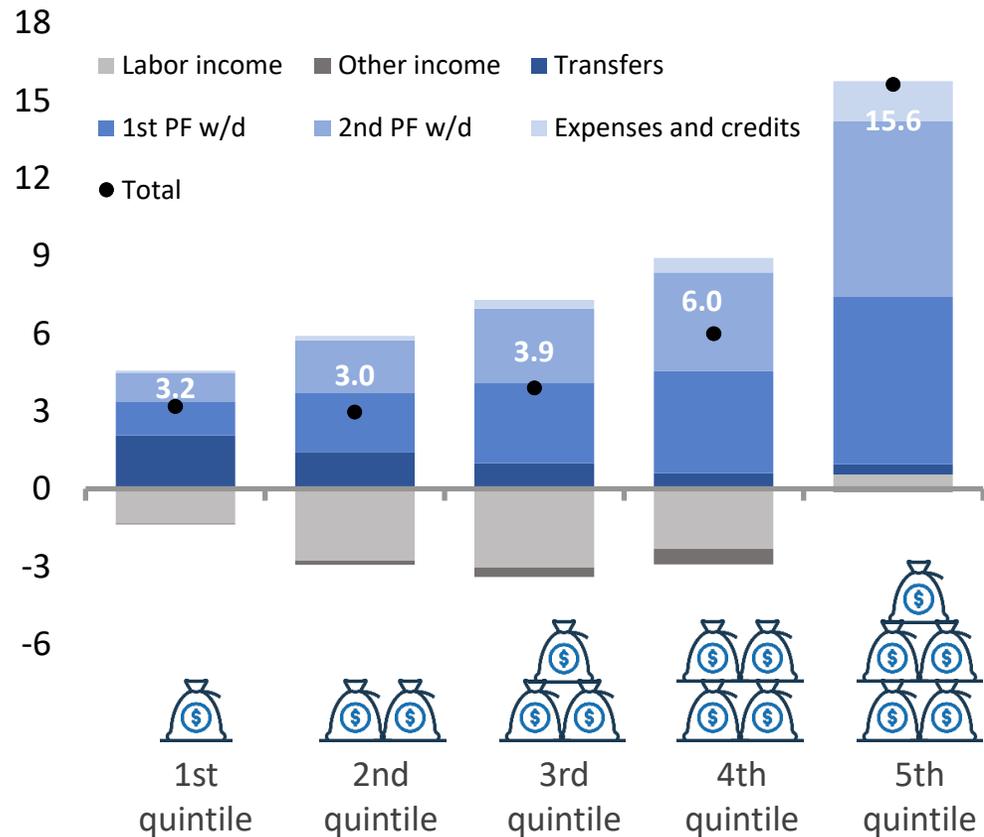
Sources: Central Bank of Chile and National Statistics Institute.



The second withdrawal of pension savings will have milder effects than the first, partly because other measures have more than compensated for the pandemic-related loss in income and the immediate spending urgencies have abated.

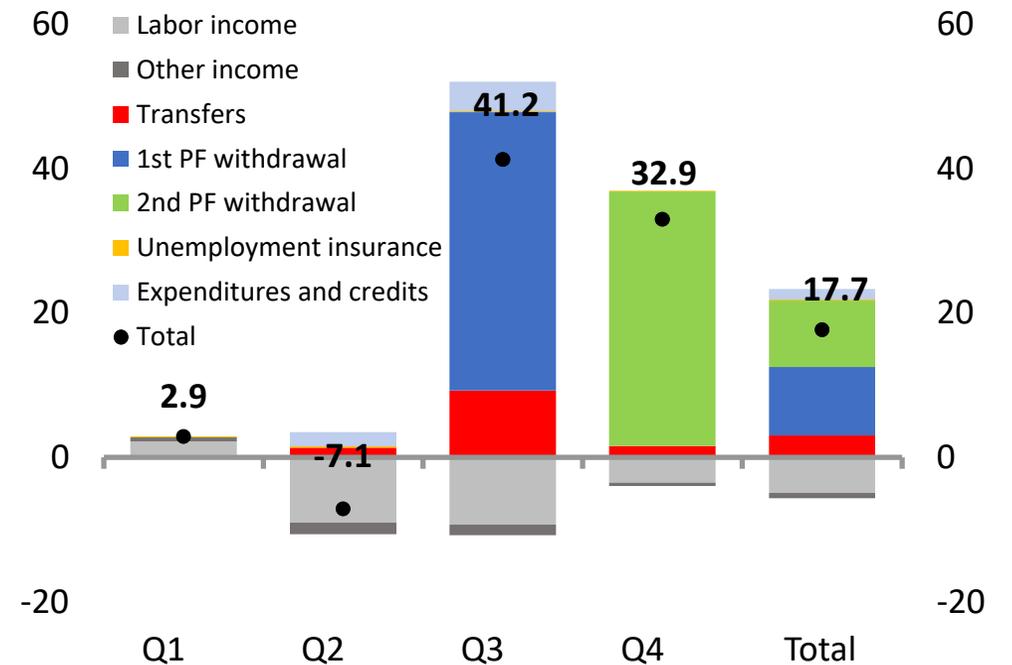
### Variation in additional liquidity and income by quintile, 2020

(in billions of US dollars)



### Effect of the support measures on household income, 2020

(annual change, percent)



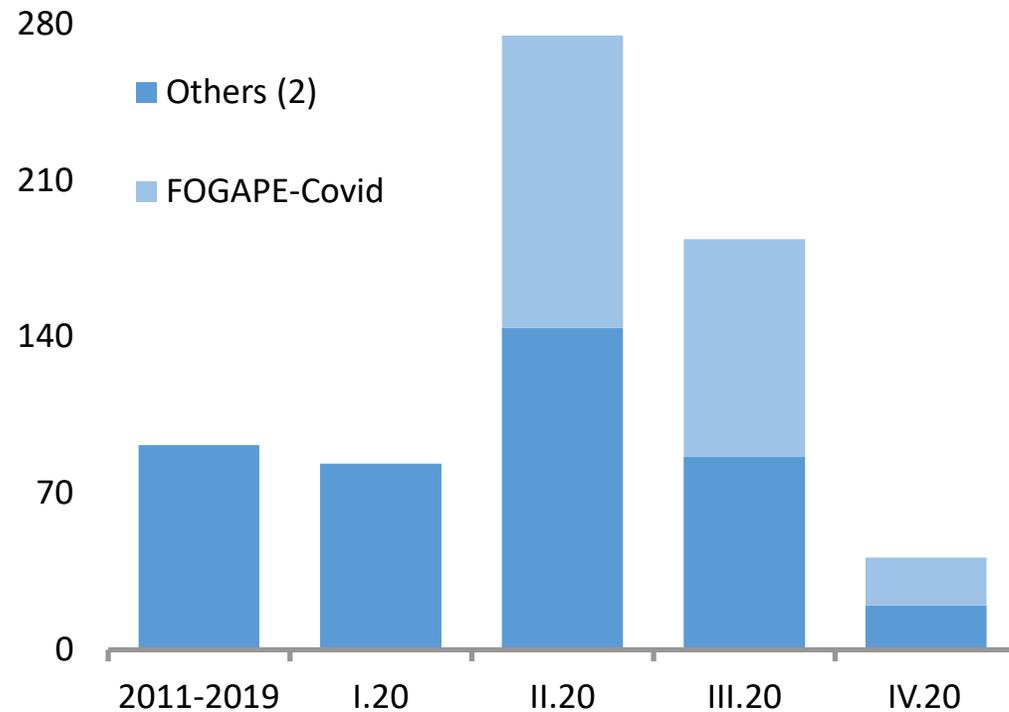
Source: Barrero *et al.* (2020).



*Credit to companies increased significantly in the midyear, responding to the measures implemented by the Central Bank and the Government. In recent months, credit has slowed down, amid improved cash flows and the heavier financial burden on companies.*

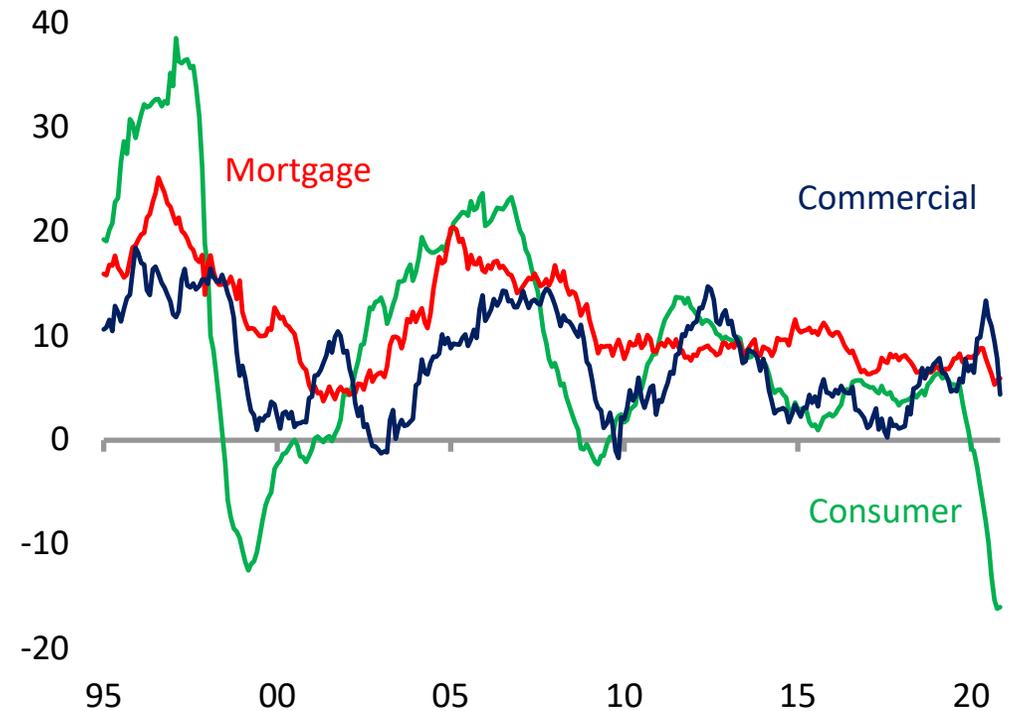
### Number of granted commercial loans (1)

(thousands of operations)



### Real loans (3)

(annual change, percent)



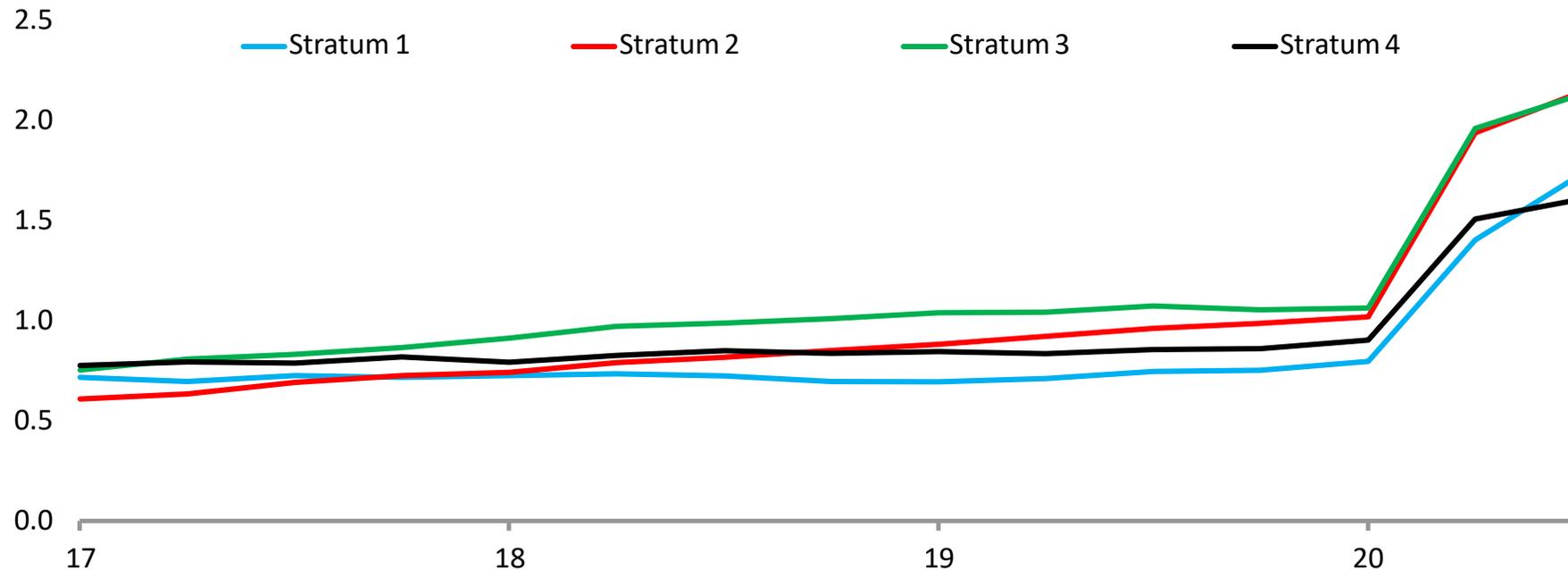
(1) For the fourth quarter of 2020, information covers until November 24th. Period 2011-2019 uses average quarterly data. (2) Excludes restructurings and factoring. (3) Actual data constructed the the CPI splicing with annual base 2018, in monthly frequency.



*The measures adopted to promote credit were well received by the financial system, allowing it to flow to companies of all sizes.*

## Indebtedness (1) (2)

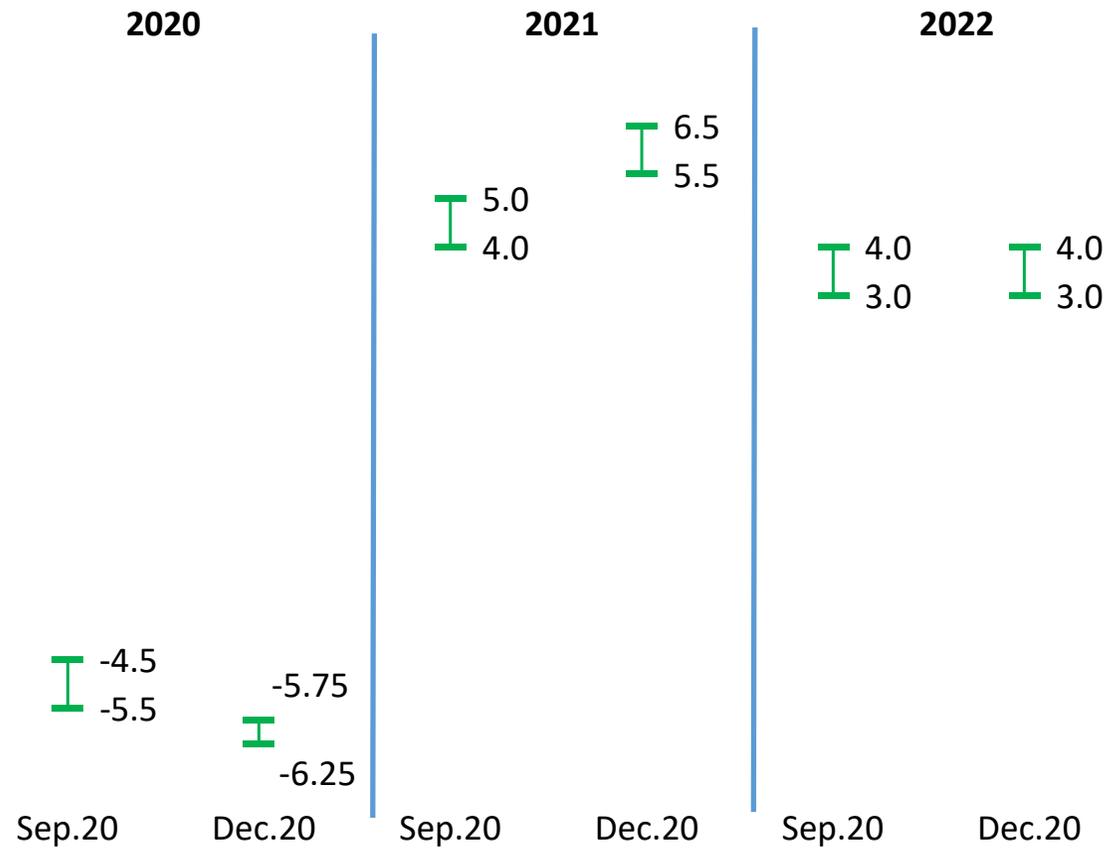
(debt/ sales ratio)



(1) The debt to sales ratio is calculated at the level of each firm for each period. The numerator is stock of banking and foreign debt of each firm. The denominator is calculated as the average of the real sales of each firm (deflated by the UF) between the third quarter of 2018 and 2019. The indebtedness by sales stratum is calculated as the median among the firms of each stratum. (2) Stratum 1 and 2: annual sales less than UF25,000. Stratum 3: annual sales greater than UF 25,000 and less than UF 100,000. Stratum 4: annual sales greater than UF 100,000. Sources: Central Bank of Chile, Commission for the Financial Market and National Statistics Institute (INE).



Activity is projected to continue to recover gradually and return to its September 2019 by the year 2022.



### Underlying assumptions:

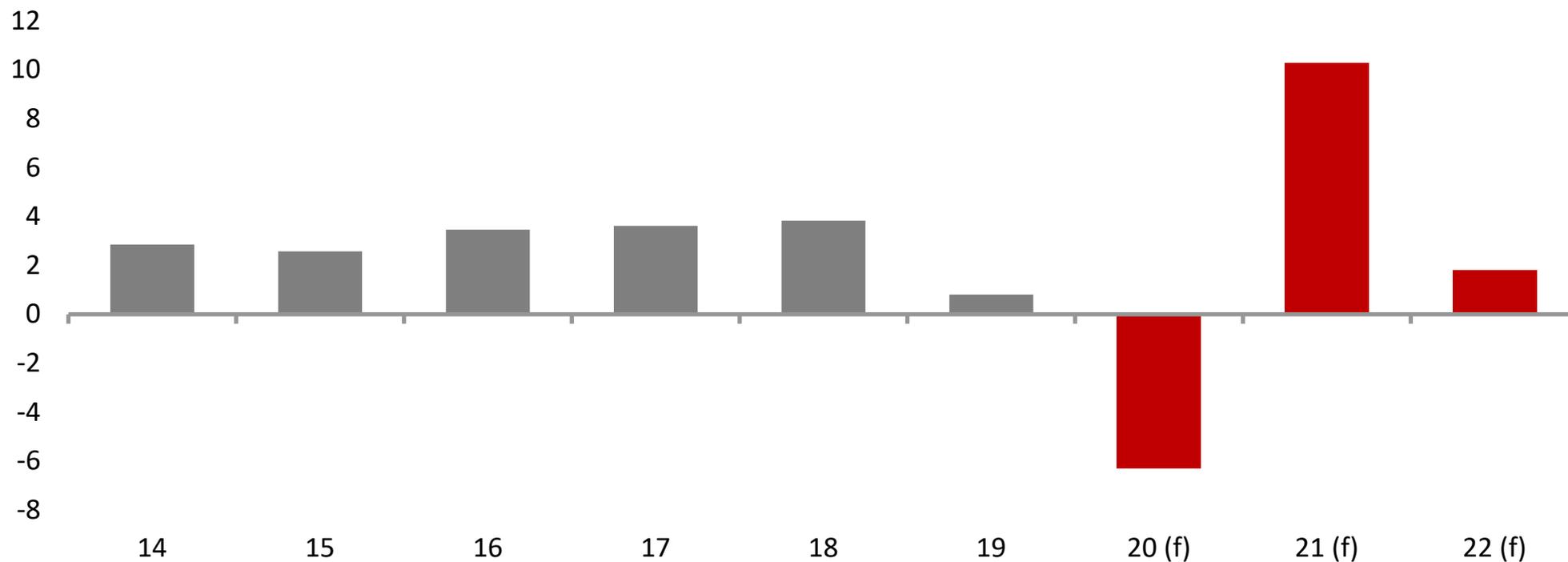
- The pandemic's evolution will allow having greater mobility levels than those of mid-2020.
- Advances in the vaccination process during 2021, as announced by government
- Still positive fiscal stimulus according with approved budget.
- Important effects next year of the withdrawal of pension savings, especially on consumption and trade-related businesses.
- Monetary policy remaining highly expansionary.



*The withdrawal of pension savings, together with improved labor income and government transfers will support next year's growth in private consumption.*

### Total consumption

(real annual change, percent)



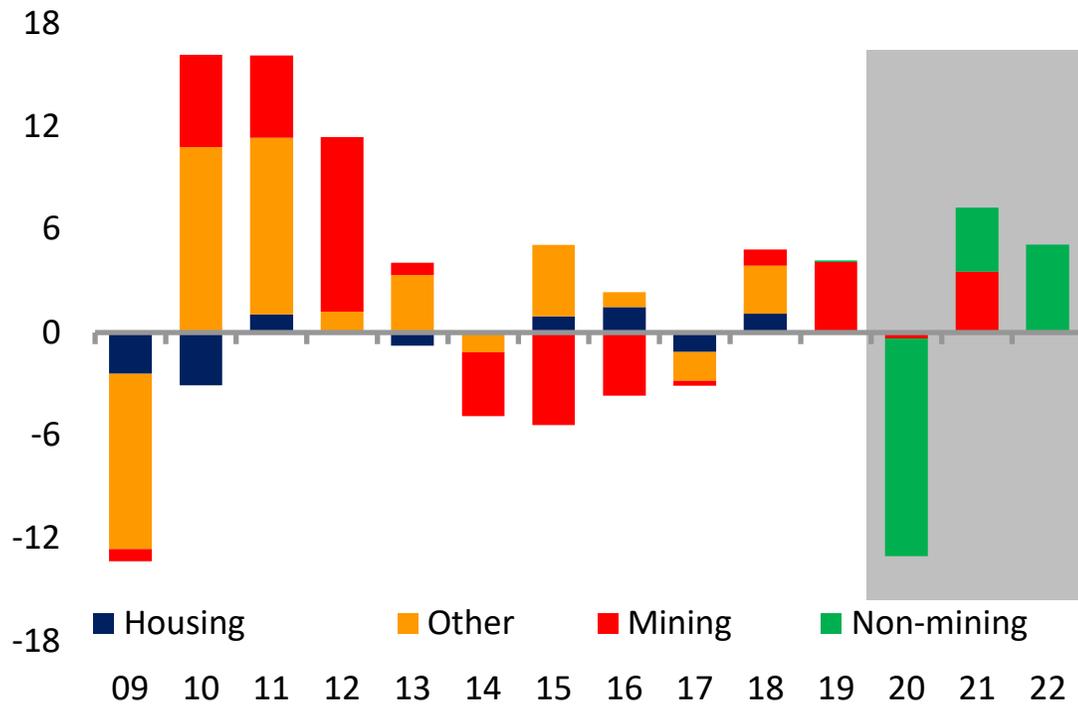
(f) Forecast.

Source: Central Bank of Chile.



*The upturn in investment for the period 2021-2022 will be slower than foreseen in September.*

**Real annual contribution to GFCF (\*)**  
(percentage points)



Asset price trends, the higher copper price and the low cost of financing support better prospects, plus public investment in infrastructure.

In contrast, investment surveys indicate that projects are concentrated in some sectors, engineering services activity remains depressed and construction has been hit by sanitary restrictions.

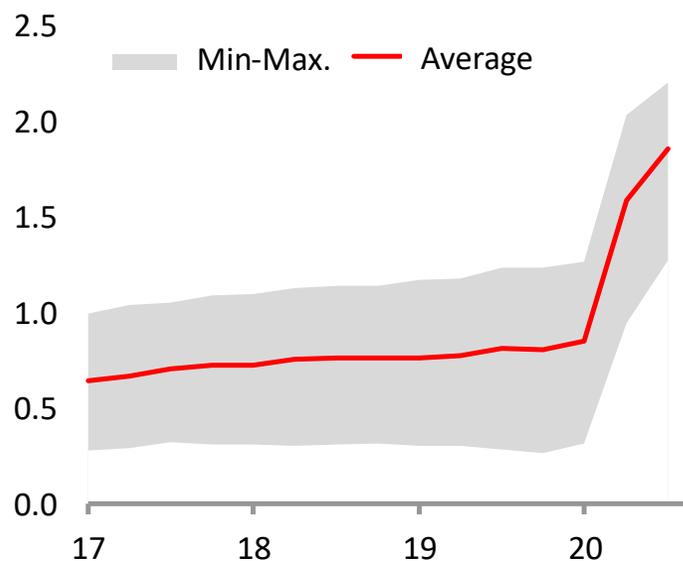
(\*) Housing investment uses household investment data from National Accounts by Institutional Sector. The Other GFCF component is treated as a residue. Forecasts for the years 2019, 2020, 2021 and 2022 are made using forecasting models of the Central Bank of Chile and sectoral sources, such as investment plans and the CBC survey.



*In addition, the slump in profitability, coupled with the greater financial burden in a context of partial economic recovery and uncertainty, could hinder the firms' capacity to undertake new projects.*

## Indebtedness: selected economic sectors (\*)

(debt / sales ratio)

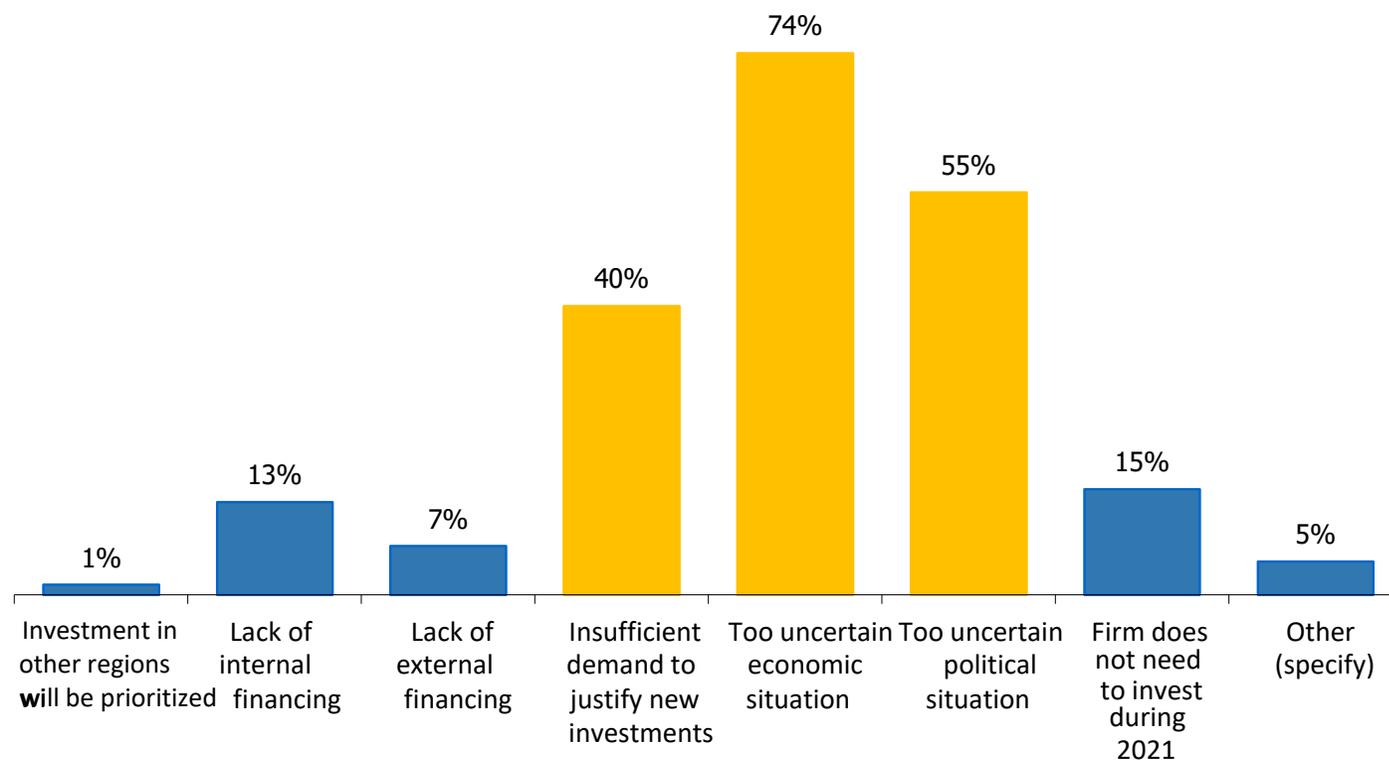


(\*) The debt to sales ratio is calculated at the level of each firm for each period. The numerator is stock of banking and foreign debt of each firm. The denominator is calculated as the average of the real sales of each firm (deflated by the UF) between the third quarter of 2018 and 2019. The indebtedness by sector is calculated as the median among the firms of each sector. The red line is the simple average between the sectors. The gray area indicates the minimum and maximum debt-to-sales ratio among the selected sectors for each period. The sectors included: business services, housing services, financial services, personal services, commerce, restaurants and hotels, industry, construction, and transportation.

Sources: Central Bank of Chile, Commission for the Financial Market and National Statistics Institute (INE).

## Question in November's Business Perceptions Report:

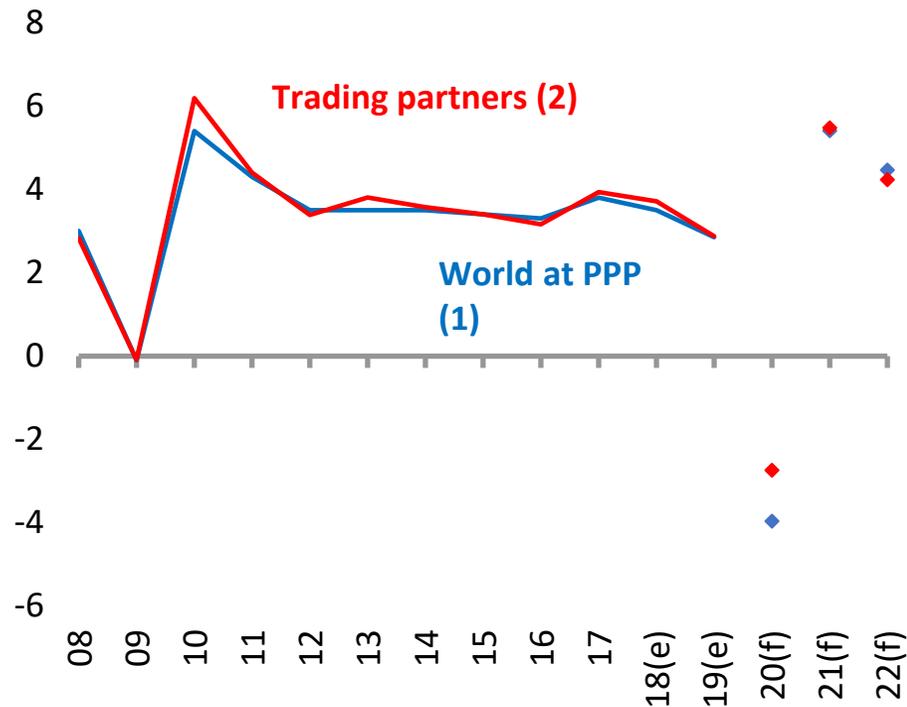
Why is your firm not planning new investments in the region in 2021? (check as many options as you wish)



*The external boost that the Chilean economy will receive in the next two years will be positive, with an improvement in the growth prospects for trade partners and the price of copper.*

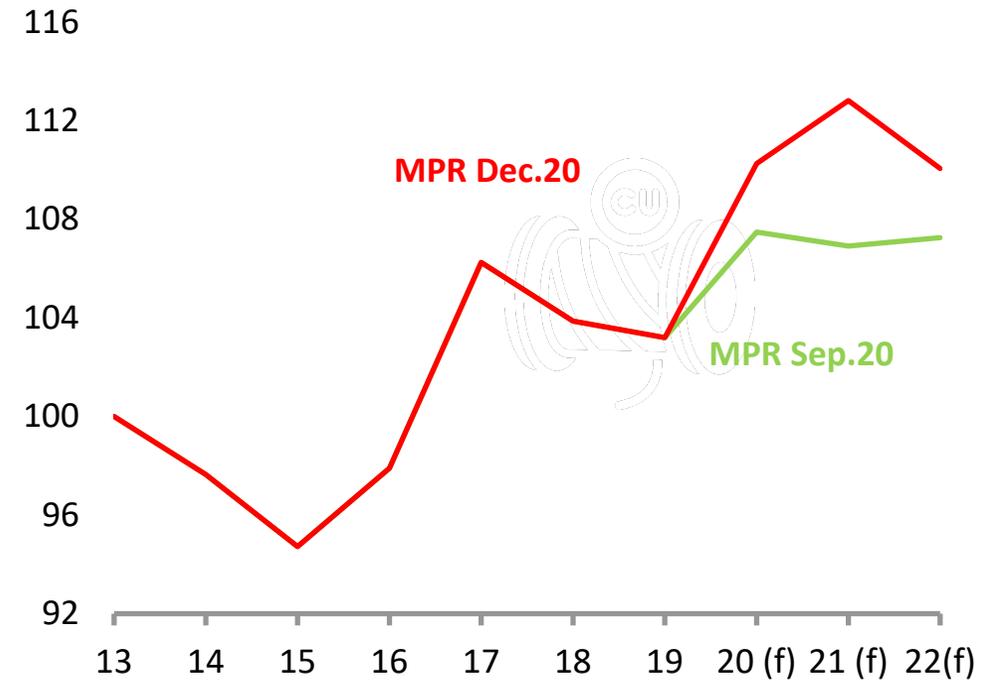
## GDP growth

(annual change, percent)



## Terms of trade

(index, 2013=100)



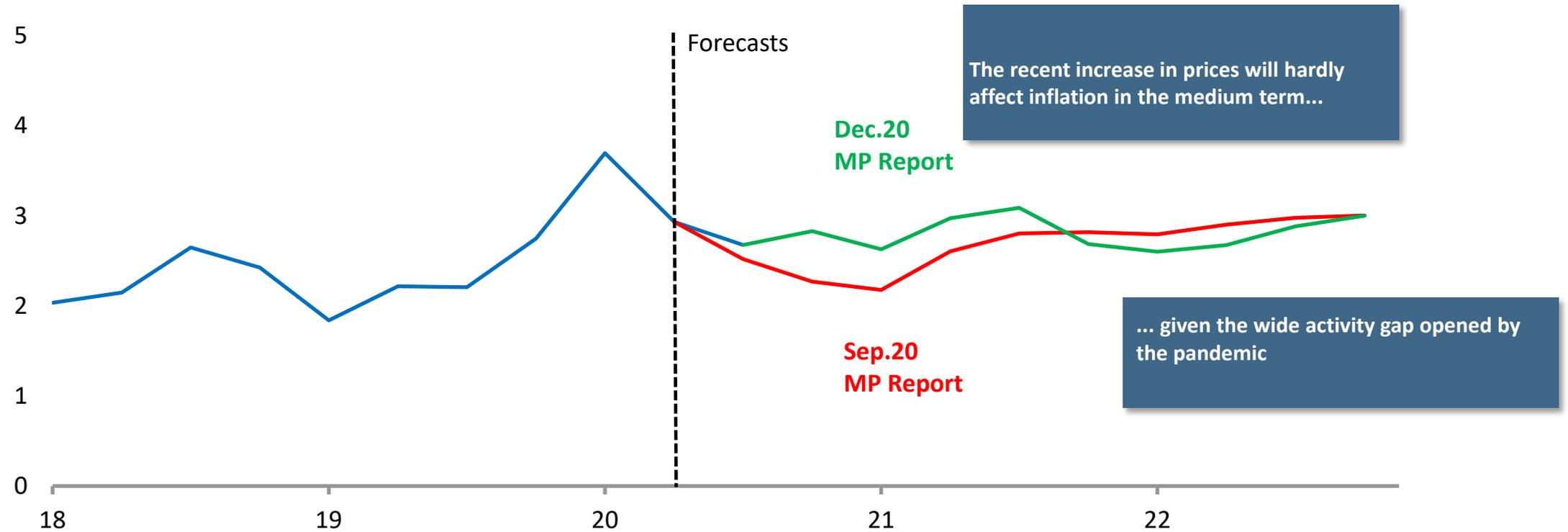
(e) Estimation. (f) Forecast. (1) Regional growth weighted by share in world GDP at PPP, published by the IMF (WEO, October 2020). World growth forecasts for the 2020–2022 period are calculated from a sample of countries that represent about 85% of world GDP. For the remaining 15%, the average growth rate of advanced and emerging economies is used. (3) The growth of Chile’s main trading partners, weighted by their share in total exports over two rolling years. The countries included are the destination for about 94% of total exports, on average, for the 1990–2019 period.

Sources: Central Bank of Chile, based on a sample of investment banks, IMF, and statistical offices of each country.



*Inflation will hover around 3.0% annually for several quarters and will consolidate its convergence to the target no sooner than 2022.*

### CPI inflation forecast (\*) (annual change, percent)



(\*) For 2018, annual CPI variation obtained by splicing the series with base 2013=100 with the monthly variations of the 2018=100 basket as from February 2018. See box IV.1 in Monetary Policy Report, March 2019.

Sources: Central Bank of Chile and National Statistics Institute.



*The Board has stated that it will maintain the high monetary stimulus for a prolonged period of time, in order to ensure the consolidation of the economy's recovery and compliance with the Bank's objectives.*



**TPM**  
%

### Conventional monetary policy

- The MPR will be kept at its technical minimum over much of the 2-year monetary policy horizon.

## Unconventional measures



### Stock of bank bonds maintained over the next six months

- Considers total bonds acquired under the different programs ( approximately US\$8 billion).
- Coupons reinvested as they mature.
- Excludes purchases under the CC-VP program.



### Maintaining available resources and FCIC utilization conditions

- The Board will evaluate possible extension and changes in access parameters, in order to facilitate its use to respond to the needs of the economy at this stage.



*After the second pension fund withdrawal was passed, the Central Bank of Chile announced a package of precautionary measures aimed at ensuring the AFPs' orderly liquidation of assets and thus preserve the stability of financial markets and the efficiency of the price formation process.*

**➔ Reopening for the remnants of the first program:**

Cash Purchase and Term Sale (CC-VP) (up to the equivalent of US\$8.5 billion).

Special program for the purchase of term deposits (up to the equivalent of US\$7.75 billion).



**Both valid from  
9 December, 2020 to  
15 February, 2021.  
From that date  
onwards, CC-VP  
operations may only  
be renewed.**

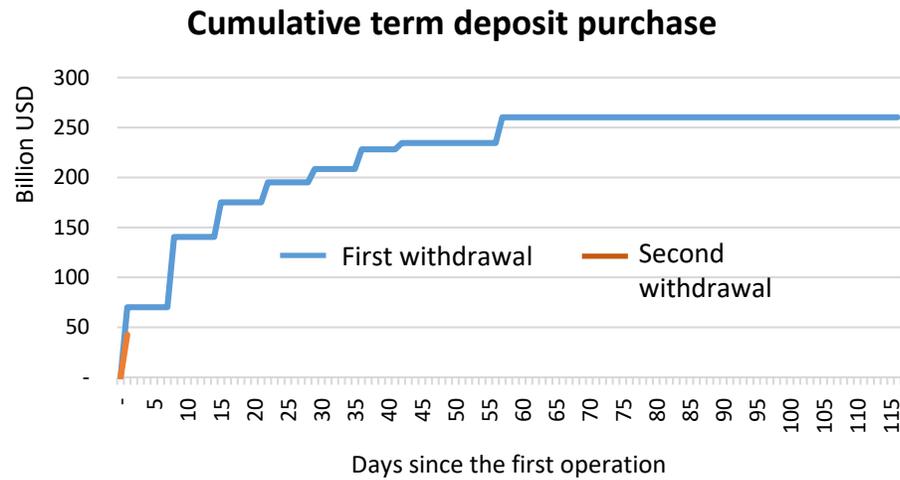
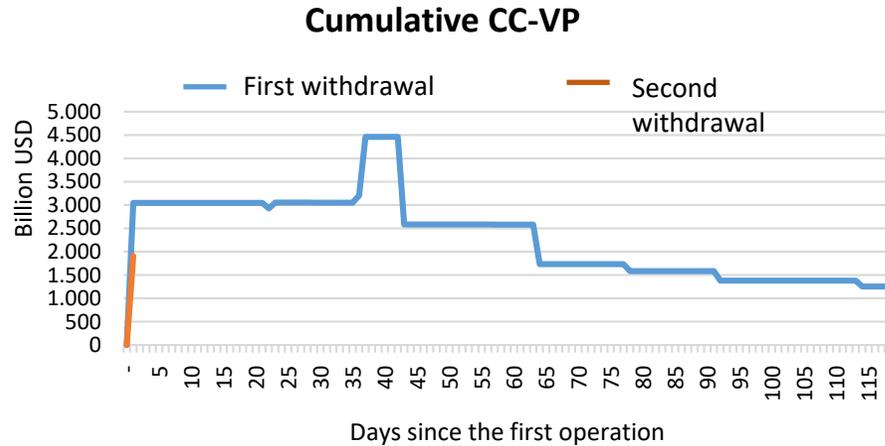
**➔ REPO window with banking companies at 7- to 180-day terms**



**Extended until May  
2021.**



In the first day of operations associated to these measures, US\$ 1. 909 billion were awarded in CC-VP and US\$ 43 million in the DAP purchase. The structure of sovereign rates showed moderate movements.



	Bonds CLP		Local markets		Amount in CLP million	
	T	T-1	Amount in CLP million	UF-indexed bonds	Amount in CLP million	
	T	T-1	T	T	T-1	T
1Y	0,29	3	409	-2,40	0	0
3Y	0,51	2	229	-2,30	0	2.339
5Y	1,28	-1	8.023	-1,30	15	8.915
6Y	1,63	-3	19.098	-0,93	0	27.591
10Y	2,83	-3	20.648	0,02	3	2.350
15Y	3,44	-4	595	0,55	0	3.607
20Y	3,90	0	134	0,98	4	624
30Y	4,20	5	1.180	1,26	8	177

\*Data at closing of 9 December 2020.

\*In the CC-VP, one Pension Fund and one non-pension fund participated in the first operation of the first withdrawal, while in the first operation of the second withdrawal, three Pension Funds participated.



*As always, there are sensitivity scenarios where the evolution of the macroeconomic scenario could call for adjustments to the monetary impulse.*



Risk balance biased downward for activity and unbiased for inflation

**Risks:**

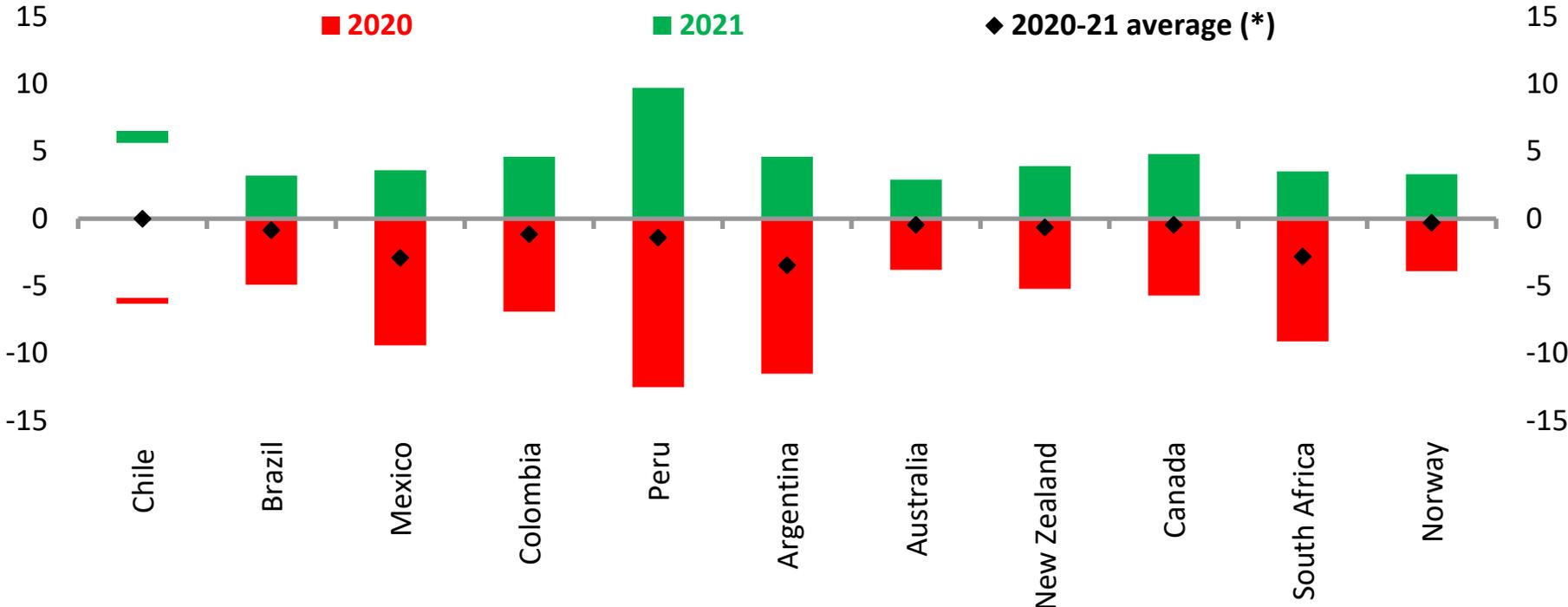
Reduced agents' capacity to respond to more negative scenarios in view of the deterioration of their asset position in the last year



The present crisis has been very different from previous episodes, not only because of its origin and speed of propagation, but also because of the capacity of economic policies to mitigate it. Indeed, projections point to a significant but brief period of contraction.

### GDP growth 2020-2021: selected economies

(annual change, percent)



(\*) For Chile, it is calculated as the average between the midpoint of the projected growth range for 2020 and 2021.

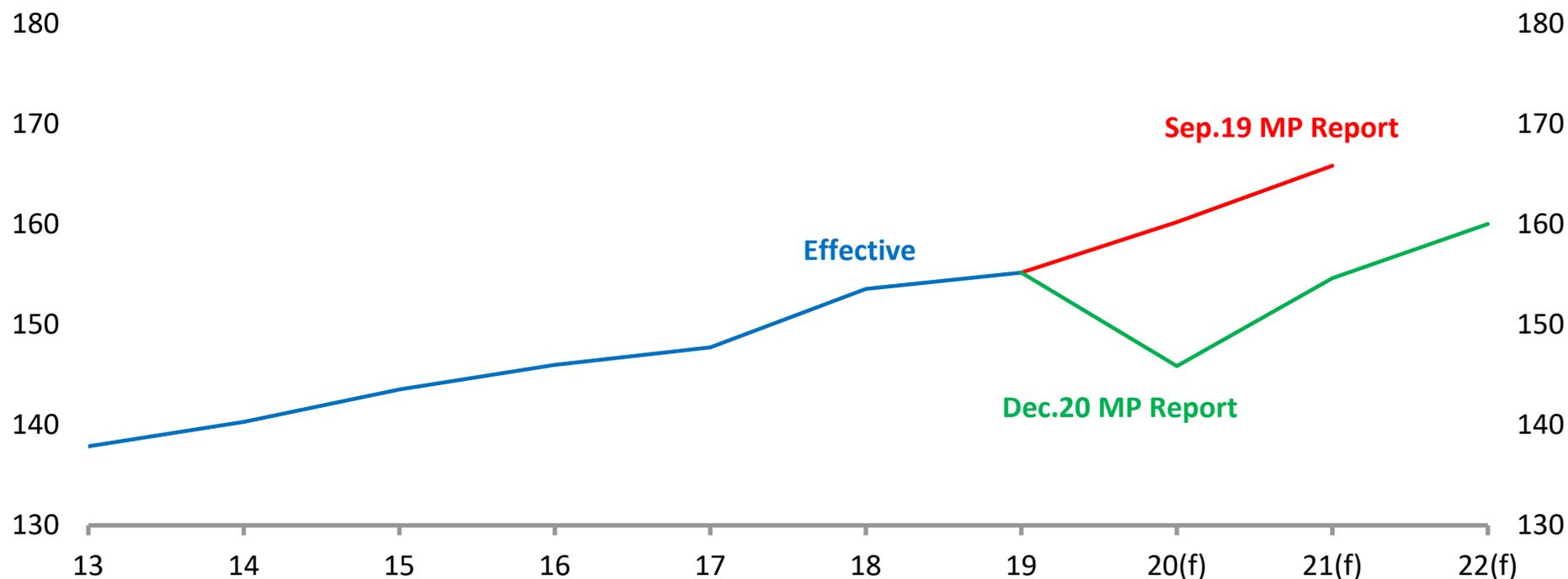
Sources: Central Bank of Chile and Consensus Forecasts.



*In any case, the Chilean economy has endured two considerable shocks in the last fifteen months, and recovering the losses will take time and lots of effort, if it is ever achieved.*

## Real GDP

(billions of CLP, volume at chained year-before prices)



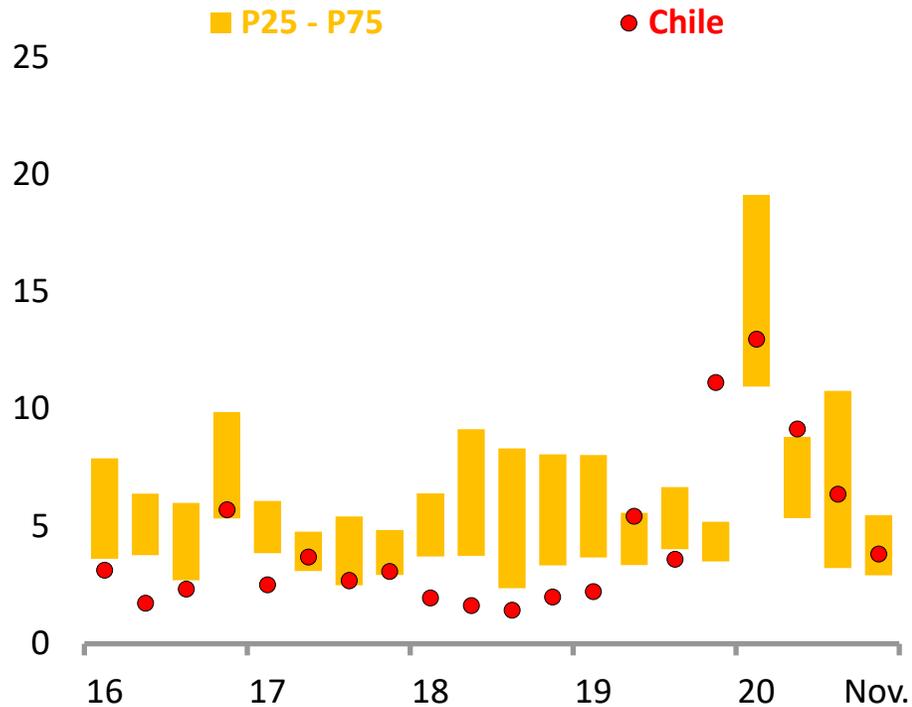
(f) Forecast. Considers the midpoint of the projected growth ranges contained in the respective Monetary Policy Report.

Source: Central Bank of Chile.

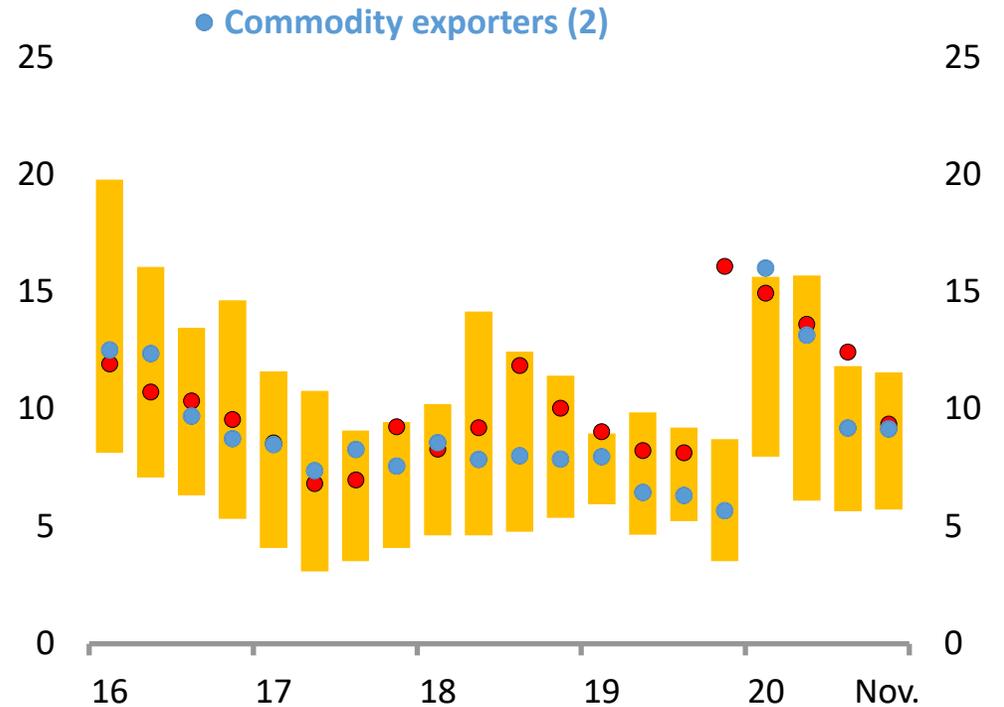


The combination of negative shocks has already caused significant stress on agents, which translates into a depletion of previous gaps and a reduced differentiation of the Chilean economy.

**Sovereign rates' volatility, EM (1)**  
(basis points)



**Exchange rate volatility, EM (1)**  
(annualized percent)



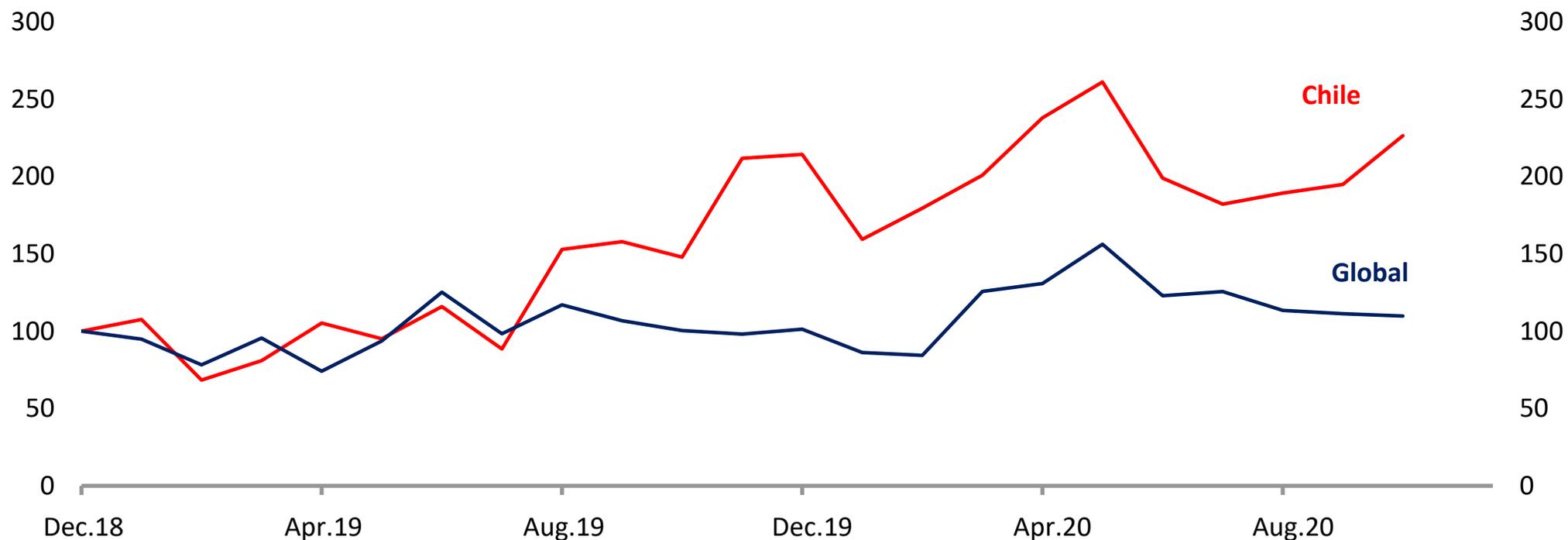
(1)EM includes Brazil, China, Colombia, Hungary, India, Indonesia, Malaysia, Mexico, Peru, Poland, Russia and Turkey. (2) Includes Australia, Canada, Norway and New Zealand.  
Source: Central Bank of Chile based on Bloomberg data.



*In addition, there has been a more far-reaching phenomenon, namely, the persistence of higher uncertainty than ever before, and that in developed countries that we have been trying to emulate over decades.*

### Uncertainty (\*)

(Dec.2018=100)



(\*) In both cases it corresponds to the Economic Policy Uncertainty Index (EPU).

Sources: Bloomberg and CLAPES UC.

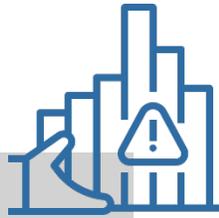


*Some short- and medium-term challenges arising from the current experience, outside the scope of responsibility of the Central Bank.*

- *Adapting the most affected sectors and businesses to the new operating conditions associated with social distancing.*
- *Fully incorporating the digital economy and teleworking into the operating design of companies.*
- *Recovering and increasing women's participation in the labor market.*
- *Adapting the profile of the financial burden to the true possibilities of companies.*
- *Reducing labor informality.*
- *Strengthening social protection systems.*



## Concluding remarks



The recovery of the Chilean economy continues to face important challenges, relating to both the evolution of the pandemic and the political and social crisis that broke out in late 2019. The central scenario assumes that the latter will follow the institutional path approved by Congress.



To handle this complex scenario, the government, firms, households and financial institutions have weathered the pressures of the last fifteen months by making extensive use of the slack accumulated in previous years, deteriorating their asset position.



A sustained, balanced and inclusive recovery will not happen spontaneously, because the economy has lost flexibility and consistency. Proactive economic policy will have to accompany it for quite some time yet.



There is no easy way to face the challenges ahead and no room for bad decisions. Well-planned and coordinated work is essential to pull the economy out of this episode. The Central Bank of Chile has been on the alert over the last fifteen months to deal with this unprecedented scenario and will continue to do so as long as it deems it necessary.

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