

*Central Bank of Chile's Workshop on
"Covid-19: Economic Implications and
Policy Lessons"*

*Policy Panel I: "Macroeconomic Policy Responses"
January 2021*

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Issues for discussion

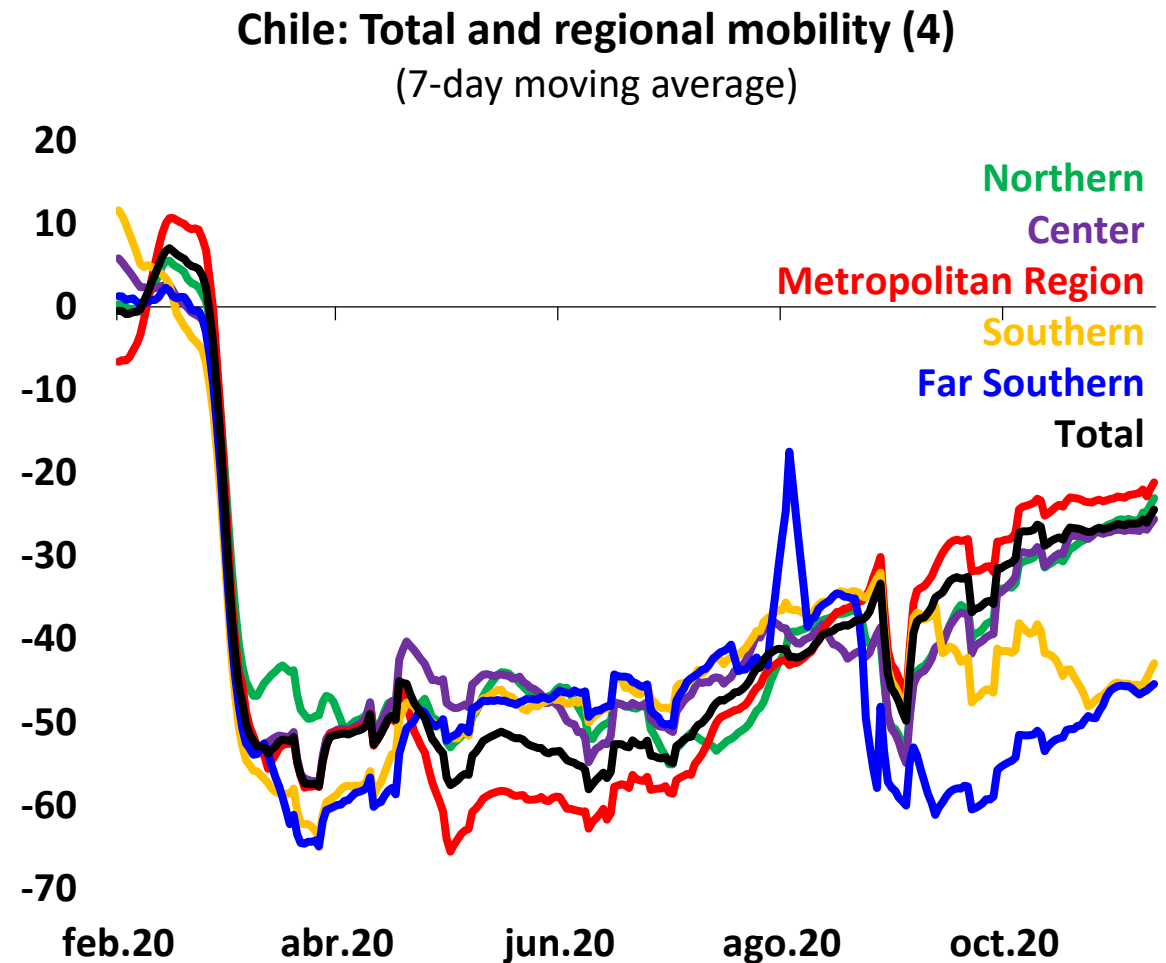
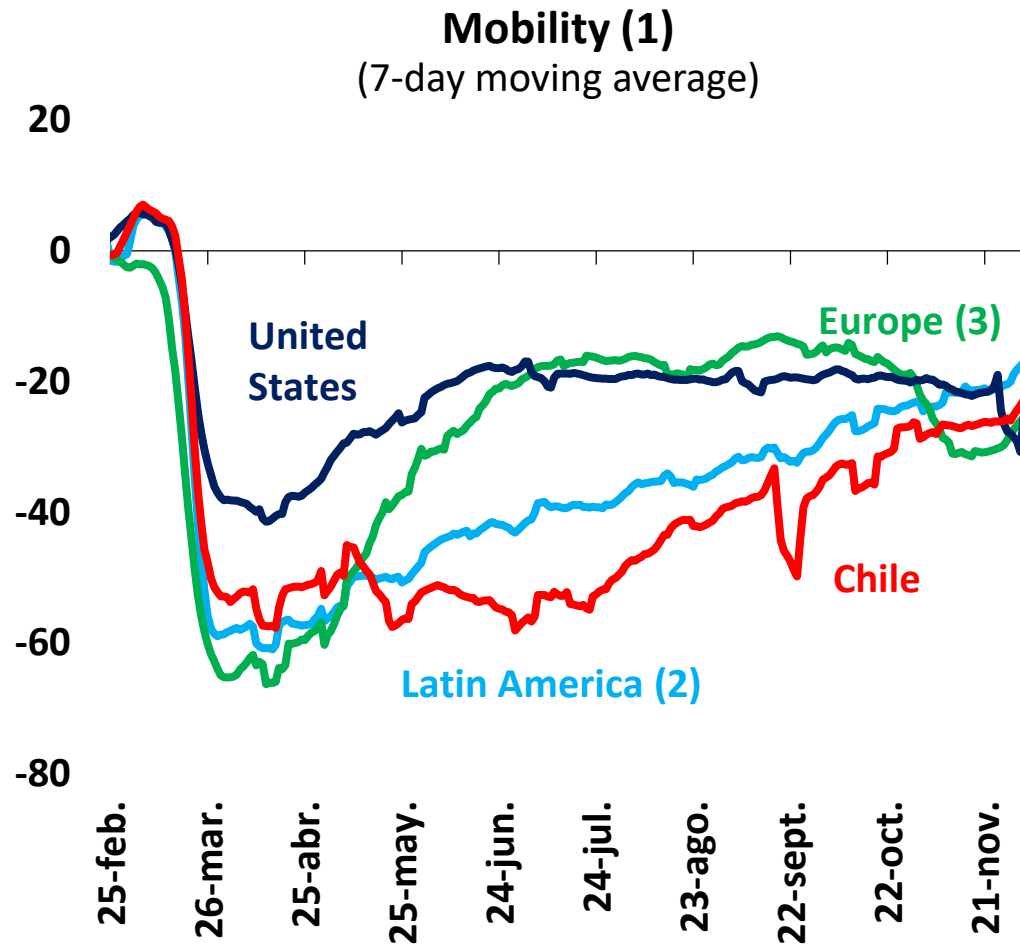
- Which fiscal and monetary/financial policies following the Covid-19 shock would you highlight as successful and according to what metric?
- What are the main challenges for monetary and fiscal policy that you see in the coming months/years?



Short-term outlook: strengths, risks, and vulnerabilities in the economic recovery

- The Chilean economy contracted significantly in March-May as a result of the Covid-19 shock and containment measures. Since then, 2/3 of the decline in activity in March-May and 1/3 of the jobs lost in that period have been recovered.
- The CBC projects a drop in GDP of -6.25 / -5.75% in 2020, a recovery of 5.5 / 6.5% in 2021 and a growth of 3 / 4% in 2022.
- In the immediate future, demand will be led by private consumption, fueled by the withdrawal of pension savings. Investment will lag behind due to the financial weakness of companies and persistent uncertainty. External conditions will be more favorable.
- So far, the recovery is characterized by heterogeneity, frictions, bottlenecks and persistent risks. It will still take a long time to achieve a harmonious and self-sustained growth, with risks of one-off price increases, a precarious recovery in the labor market, company bankruptcies and tensions in financial markets.
- Economic agents will face these risks with the wear and tear of 15 months of tension and restrictions and the consumption of a significant part of the buffers accumulated over two decades.
- Continuing support from macro policy will be needed until the economy gives clear signs of consolidation and capacity for self-sustained expansion.

Activity has recovered, hand in hand with the lifting of stricter sanitary restrictions, increased mobility and the gradual adjustment of people and companies to operating conditions in a pandemic.

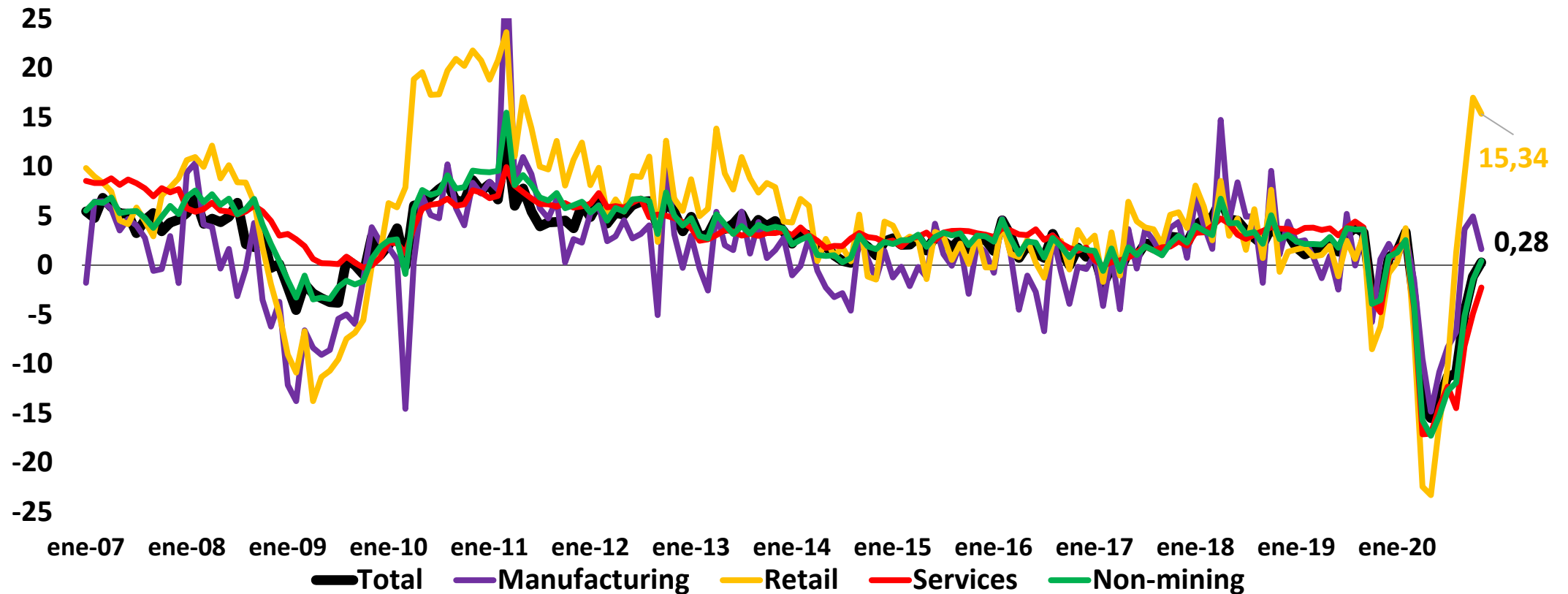


(1) Corresponds to the average of the categories shops and leisure, supermarkets and pharmacies, transport stations and workplaces. (2) Simple average between Argentina, Brazil, Mexico, Colombia and Peru. (3) Simple average between Germany, Spain, France, Italy and the United Kingdom. Source: *Covid-19 Community Mobility Report*, Google Inc. (4) Sources: Bloomberg and Oxford University. (4) With information until Dec. 13, 20. Google Index shows changes from the reference value (median of that day of the week corresponding to the 5-week period from January 3 to February 6, 2020). Source: Central Bank of Chile, Government of Chile, Google LLC.



The Chilean economy has recovered part of the sharp decline it suffered in the first half of the year, although at a slower rate than anticipated, and with marked differences across sectors.

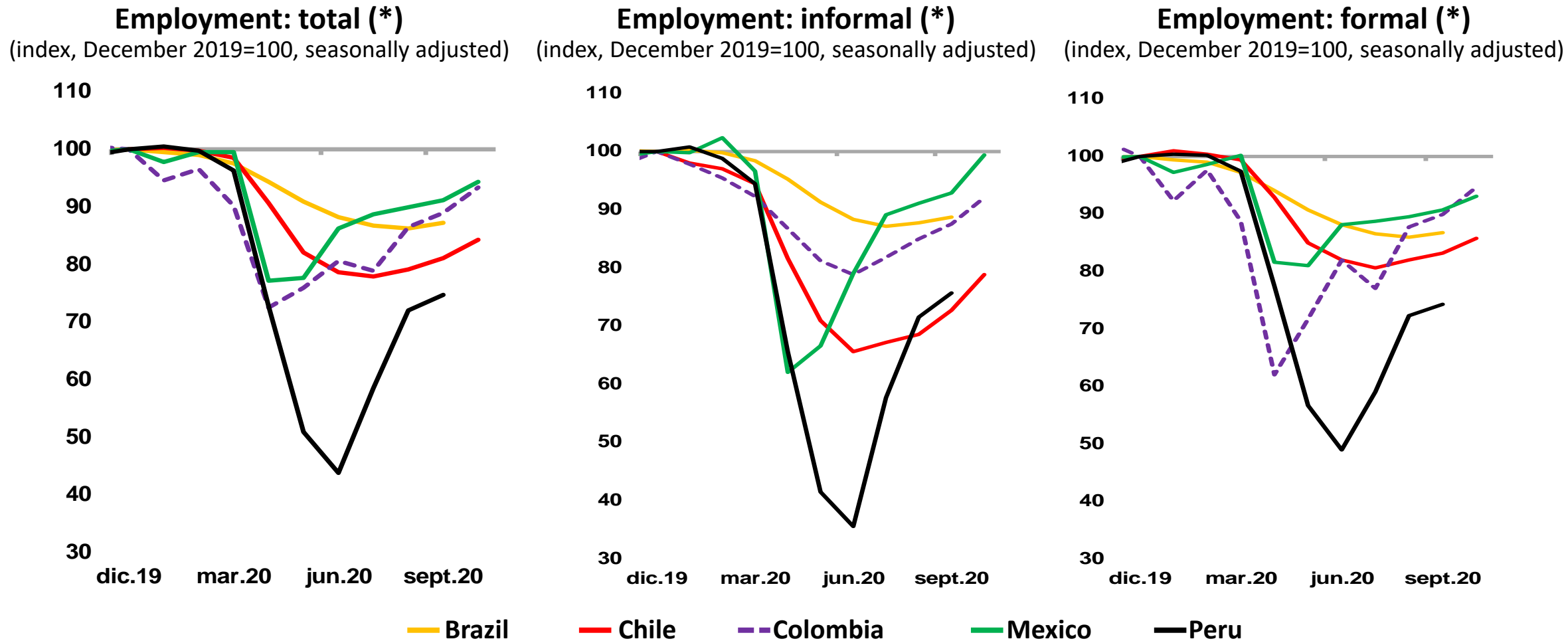
IMACEC: Total, Manufacturing, Retail, Services, and Non-mining (*)
(annual variation, percentage)



(*) Source: Central Bank of Chile.



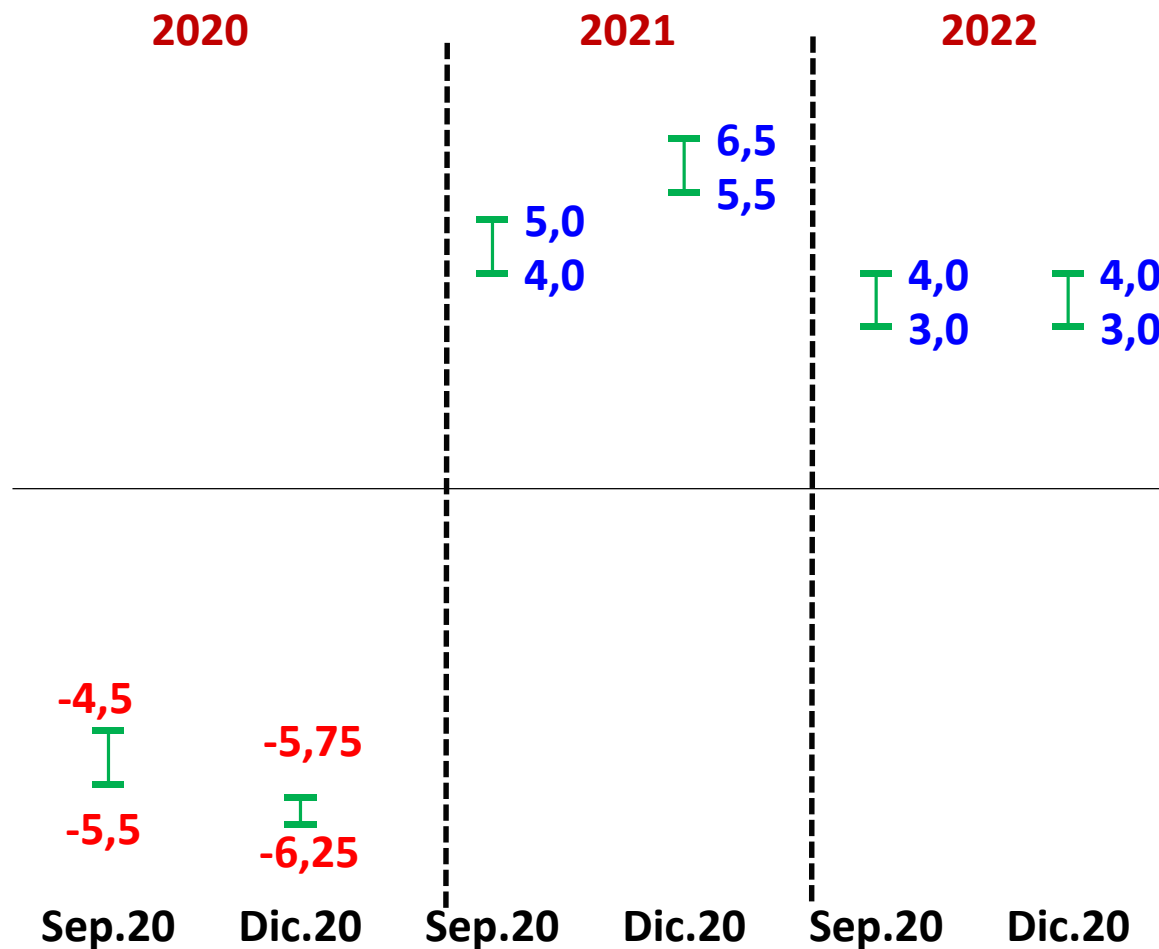
The increased mobility and sectoral disparity in the recovery have also been reflected in the labor market.



(*) Source: Bloomberg.



The economy will contract between 6.25 and 5.75% in 2020, while 2021 it will grow between 5.5 and 6.5%. In 2022, GDP may grow between 3.0 and 4.0% as the economy consolidates its recovery process and closes gaps.



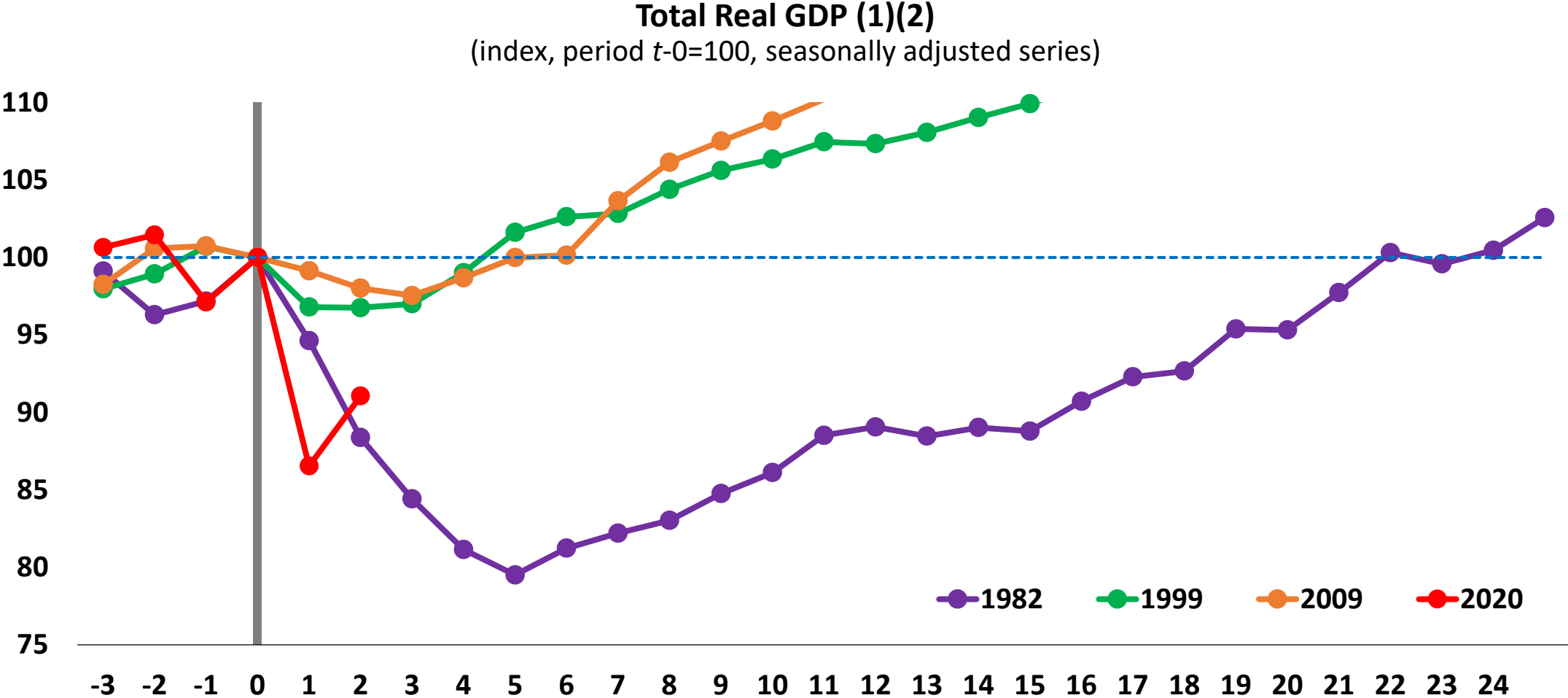
(*) Source: Central Bank of Chile.

The projections contemplate:

- The evolution of the pandemic will allow maintaining mobility levels higher than those of mid-2020
- Progress in the vaccination process during 2021, in accordance with what was announced by the Government
- Fiscal stimulus that will continue to be positive, according to the approved budget; more favorable external conditions
- Relevant effects of retirement savings in 2021, especially in consumption and trade-related items
- Monetary policy will remain highly expansionary



The decline in activity this time was sharper than in any other recession in the last 40 years, but the recovery started much earlier.



(1) Respective zero periods: 1981, IV, 1998, IV, 2008, IV and 2020.I. (2) Official seasonally adjusted spliced series for all periods except 1982-83. For that period, the series contained in the volume "Economic and Social Indicators 1960-1988" was seasonally adjusted. Source: Central Bank of Chile.



To face this unprecedented shock, a strong fiscal and monetary impulse was required. The Central Bank adopted a score of measures in four areas.

Conventional Monetary Policy

- Monetary Policy Rate cut by 125 bp to its estimated effective zero lower bound
- Forward guidance

Unconventional Monetary Policy

- FCIC1
- FCIC2
- Collateral expansion
- Asset purchase program



Enhance Policy Space

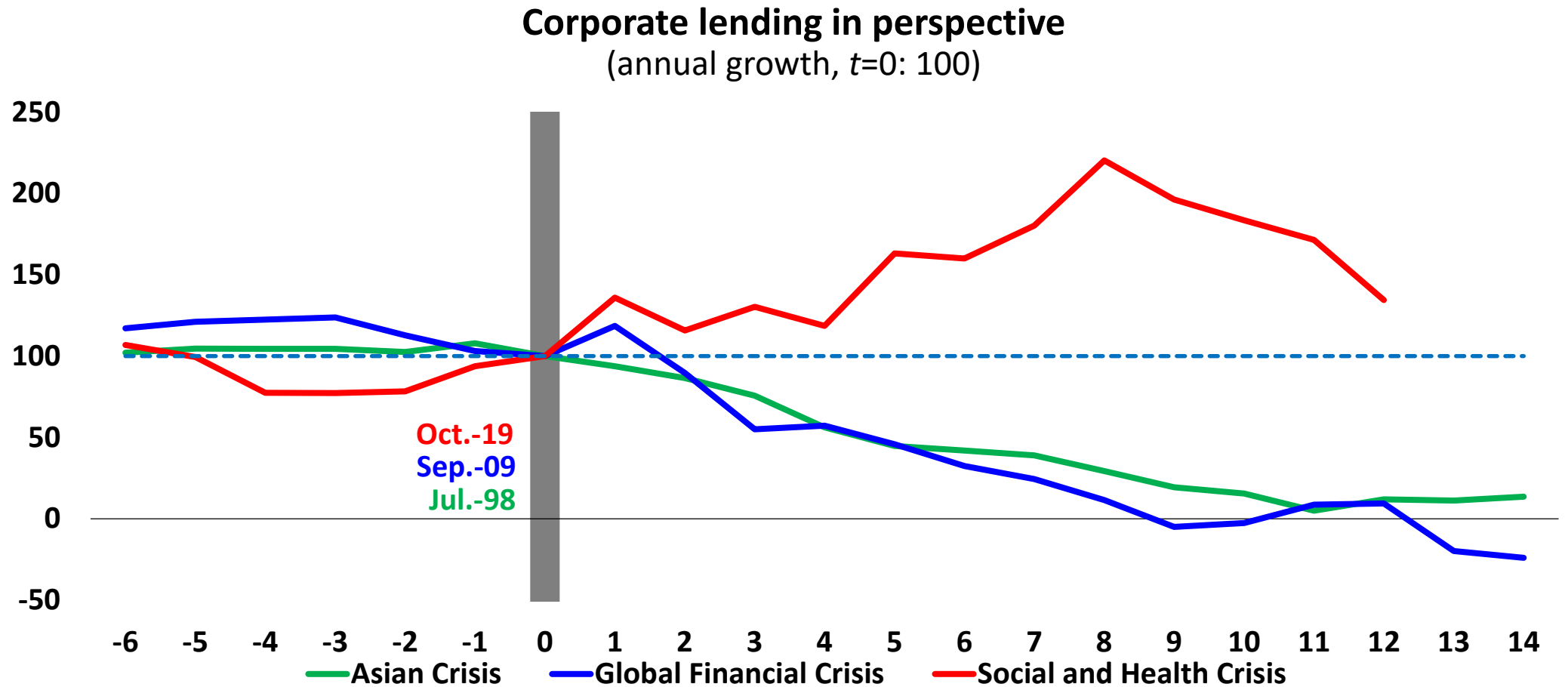
- IMF *Flexible Credit Line*
- Repo and swap lines with central banks
- Constitutional reform on the purchase of Treasury bonds in the secondary market
- Internationalization of the CLP

Market Stabilization

- Swap and Repo to provide CLP and USD liquidity
- FX intervention
- Buy selloff bonds
- *CC-VP* and purchase DAP due to pension savings withdrawal



Bank lending grew in 2020, in sharp contrast with contractions in previous recessions. Corporate lending responded to policy measures from the Government, the Central Bank and the Financial Regulator.



(*) The period $t = 0$ corresponds to Jul-98 for the *Asian Crisis*, Sep-09 for the *Global Financial Crisis* and Oct-19 for the *Social and Health Crisis*. Source: Central Bank of Chile based on information from the CMF.



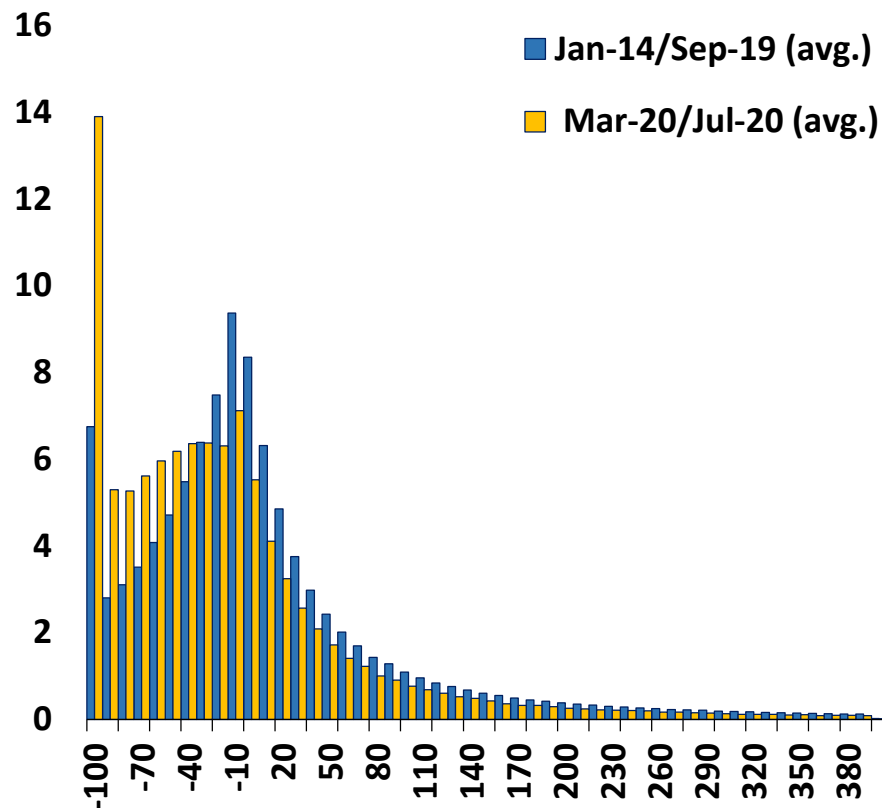
Conducting economic policy across a global crisis

Monitor the economy in real time	Dig below aggregates, understand distributions	Identify potential spillovers	Design effective policy responses	Communicate policy decisions, set expectations
<ul style="list-style-type: none">• Access and use big data• Apply ad-hoc surveys• Collect qualitative information	<ul style="list-style-type: none">• Access and combine administrative databases	<ul style="list-style-type: none">• Combine administrative databases• Conduct microsimulations• Use financial stability councils	<ul style="list-style-type: none">• Draw lessons from recent history• Exchange with peers• Conduct microsimulations• Coordinate with other policymakers and regulators• Assess results	<ul style="list-style-type: none">• Explain foundations of policy decisions• State objectives• Set timeframe• Assess results• Create conditions for rollback, exist strategy



Assessing the impact of the pandemic on firms' cash flows

Distribution of real annual sales growth (1)
(share of total firms)



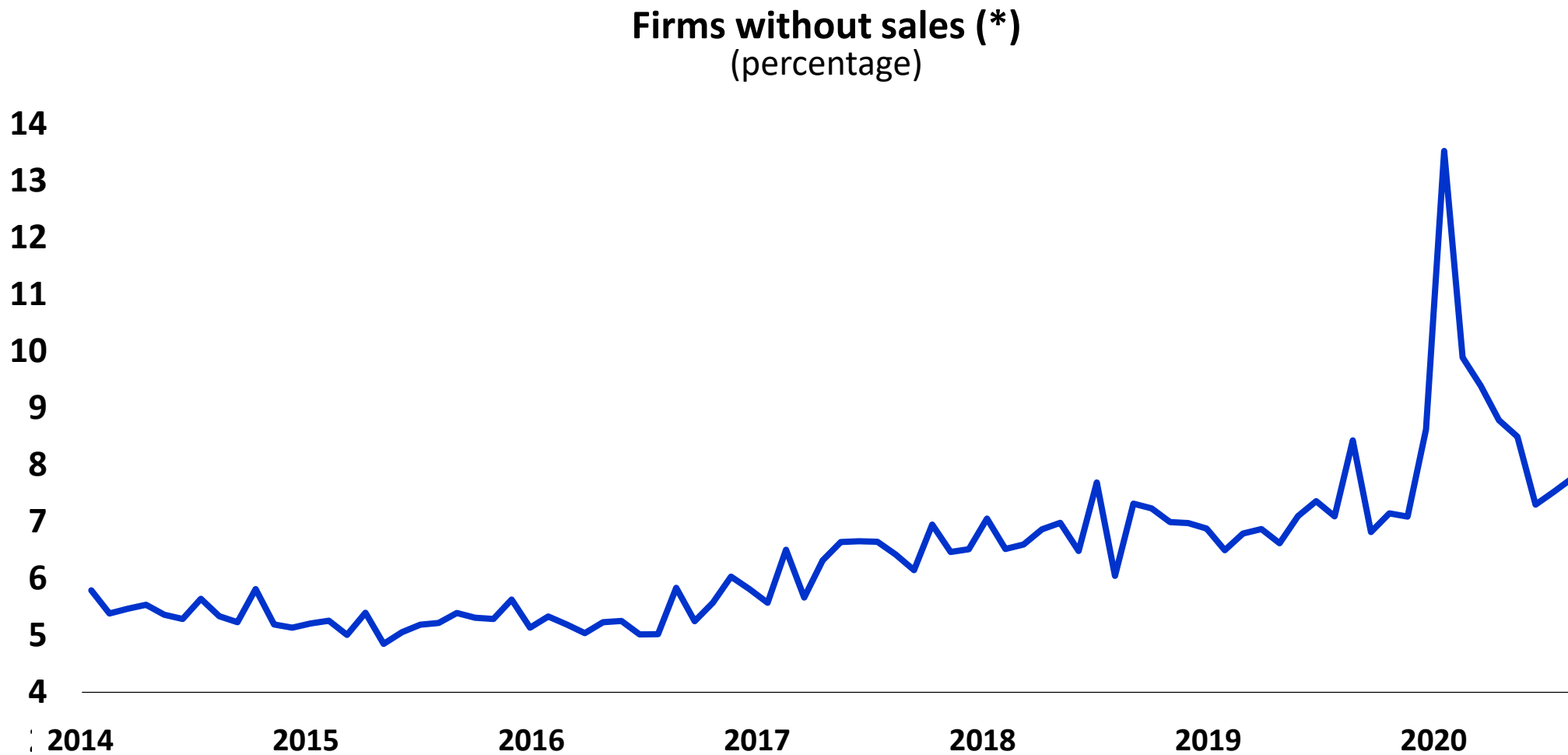
Sectorial evolution of sales: Mar-20/Jul-20 (2)
(percent)

Sector	Sales growth, average (3)	Share of firms (4)	Share of firms with "non reporting" (5)	Share of firms with "significant drops" (6)
Manufacturing	-14.2	15.8	15.2	31.1
Construction	-11.8	13.7	24.1	30.2
Retail	-12.8	31.8	16.1	29.0
Transportation	-6.2	11.2	11.8	20.7
Financial services	-6.0	2.0	15.3	22.7
Housing	-18.0	1.7	20.3	22.5
Entrepreneurial services	-12.5	11.8	18.1	27.6
Personal services	-18.1	5.0	26.0	26.6
Restaurants and hotels	-39.9	6.9	41.9	23.6

(1) Based on information from the electronic invoice. Annual sales growth calculated on a monthly basis for each firm. Source: Central Bank of Chile. (2) Based on information from the electronic invoice. (3) Simple average of the annual variation of sales. (4) Corresponds to the calculation for the period Feb.19-Mar. 20. (5) Share of firms that stopped reporting sales on the electronic invoice. (6) Corresponds to companies with annual sales drops of over 70%. Source: Central Bank of Chile.



Corporate cash flows in perspective



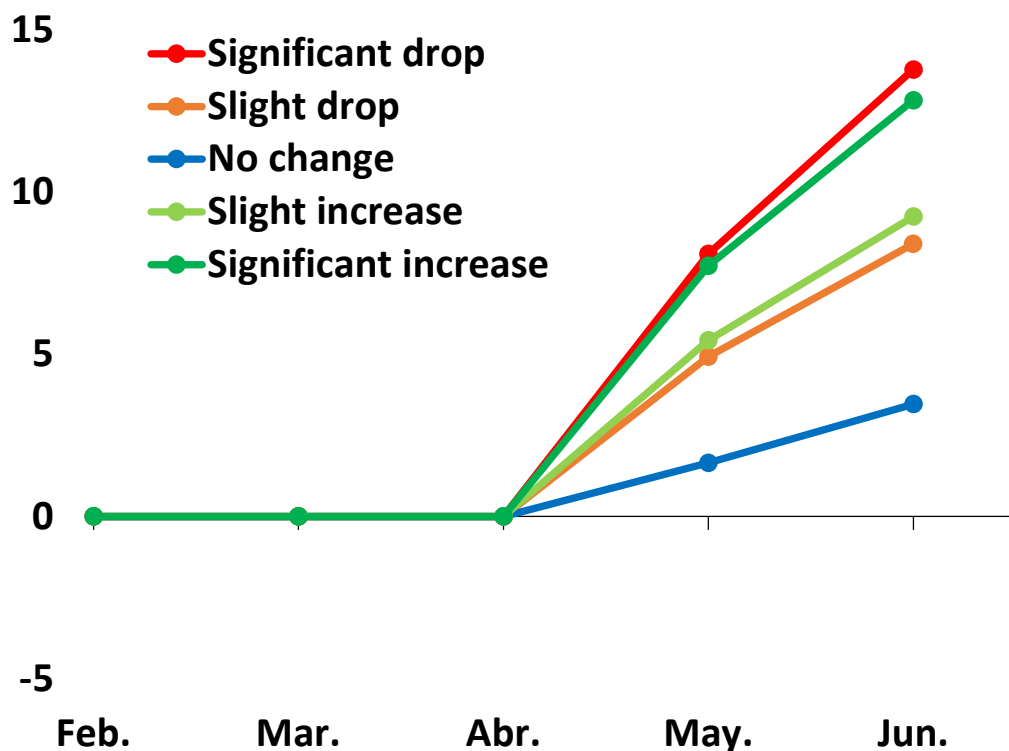
(*) Firms that in the previous period registered sales (positive or null) and in the period of analysis have no sales record. Public administration is excluded. Sources: SII and Central Bank of Chile.



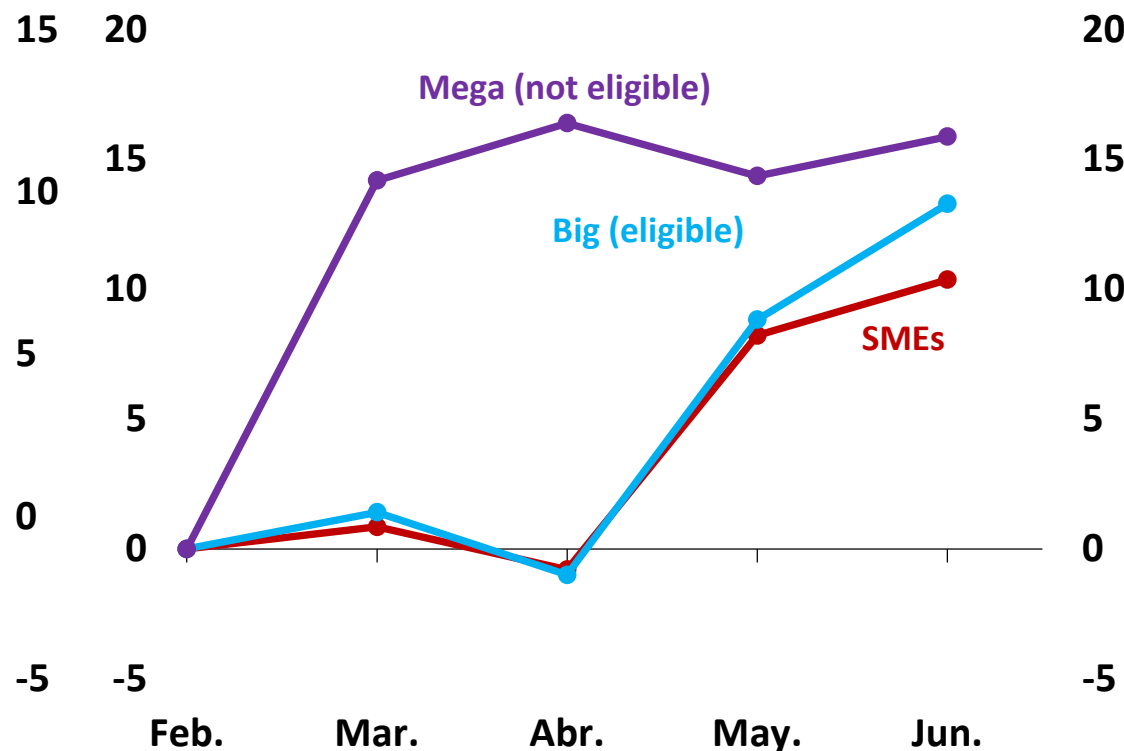
Loans granted through the FOGAPE-Covid-19 programs channels, to a greater extent, to companies that have had significant drops in their sales.

Stock of commercial credits by size and behavior of sales
(change in annual variation compared to February 2020, percent)

(a) Credits granted with FOGAPE Covid-19 programs (*)



(b) Stock of commercial credits (*)



(*) The companies are classified into three groups: (i) Micro, small and medium-sized (MiPYME), which have annual sales of less than 100,000 UF, (ii) Large, which have annual sales between 100,000 UF and 1 million UF; and (iii) Mega-large companies, which have annual sales of over 1 million UF. By regulation, MSMEs and large companies are eligible by size for the FOGAPE-COVID-19 program, while mega-large companies are not. For further detail, see Box II.2 in *Monetary Policy Report*, September 2020. Source: Central Bank of Chile using data from the Financial Markets Commission and the National Statistics Institute (INE); and Huneus *et al.* (2020).



Credit measures are negatively and statistically significantly correlated with the operational continuity of the firms. An increase in the ratio of the change in debt to sales by 1% reduces the probability of non-reporting by 0.5% and 2.1% respectively.

Analysis of the determinants of firm adjustments in Chile (†)

	(1)	(2)	(3)	(4)	(5)	(6)
	Non reporting	Non reporting	M&E	M&E	C&W	C&W
Sales growth	-0.0363*** (0.00203)	-0.0386*** (0.00227)	0.0732*** (0.0230)	0.108*** (0.0380)	0.00414 (0.00494)	0.00191 (0.00848)
Credit growth	-0.00444*** (0.00109)		0.0226* (0.0133)		0.00135 (0.00272)	
Sales growth × Credit growth	0.00115 (0.00151)		0.0128 (0.0179)		0.00139 (0.00374)	
New credit=1		-0.0198*** (0.00267)		-0.0255 (0.0483)		-0.0192* (0.0103)
New credit=1 × Sales growth		0.00855** (0.00382)		0.180*** (0.0667)		0.00522 (0.0145)
Constant	0.0787*** (0.00137)	0.0890*** (0.00158)	-0.192*** (0.0161)	-0.363*** (0.0275)	-0.00958*** (0.00340)	-0.0155** (0.00605)
Observations	41874	46483	30314	33920	44766	50331
Adjusted R-squared	0.048	0.048	0.015	0.028	0.001	0.001

(†) Standard errors in parentheses. (*) $p < 10\%$, (**) $p < 5\%$, (***) $p < 1\%$. All estimates includes size, sector, and age dummies. Each column shows the results of linear regressions at the firm level, where the dependent variable takes the value of 1 if it is in "no report" between June and July 2020 or 0 if it is not (columns 1 and 2); or takes the value of the growth of the investment flow in M&E or in C&O in those two months, relative to the historical bimonthly average, scaled by its historical sales (columns 3-6). The explanatory variables are of 4 types: growth in average sales between March and May 2020; a variable that collects bank credit; the interaction between these two; and fixed effects for size, sector and age of the firm. The credit variable used in columns 1, 3, and 5 is the increase in the bank credit stock between the end of February and May, scaled by the historical sales of the firm. The credit variable used in the remaining columns (2, 4 and 6) is a binary variable that takes the value of 1 if the firm had a new credit (FOGAPE or traditional) or rescheduling, between March and May. Source: Central Bank of Chile.



Emergency measures should focus on the short term, with clear exit strategies. The most permanent reforms are aimed at long-term objectives.

Emergency measures

- **CBC:** Bank liquidity waivers, checking chamber regulation and investment coverage flexibility. FCIC, liquidity measures, exchange intervention
- CC-VP, purchase of bank bonds and DP
- FOGAPE (*BancoEstado*).
- **CMF:** Classification of rescheduled credits; valuation guarantees.
- **MoF:** FOGAPE and Covid credits.

- **Miscellaneous:** CSV prudential safeguard, market agents, facilitate bond issues, limit pension funds for alternative assets.
- Facilitates bankruptcy proceedings.
- Retirement of pension savings.

Long-term reforms

- **CBC:** FX regulation, dollar clearinghouse, CCyB and low value payment infrastructure.
- **CMF:** Basel III regulatory framework, cybersecurity and internal restructuring.
- **MoF:** Charge rates Bill, access to CBC services Bill, crowdfunding/FinTech proposals.

Measures may be introduced in the emergency response which, although designed to solve short-term problems, have more permanent and negative implications.



Immediate prospects and challenges

- **After these long 15 months of crisis, it is important to focus on the next 15 months, because this will be a long year with many definitions that will mark the future of the country.** The recovery of the economy, the vaccination of the population, the election of new authorities and the development of a new Constitution have projections of enormous importance.
- **In the economic realm, the recovery is not predetermined as in a textbook.** There are many definitions of the economic agents and policies that will determine the strength, sustainability and inclusiveness of such a recovery.
- **This period cannot be approached with a passive or defensive attitude.** The policies and measures that served to contain the crisis are not necessarily those that are required to guide the recovery. It will be key to advance new lines through which the Chilean economy can be built in the coming decades.
- **Some remaining risks:**
 - Extension of pandemic, pick-up in contagion, delays in vaccination process
 - Corporate debt sustainability
 - Unveiling risk in bank portfolios after emergency measures
 - Recovery of labor market
 - Uncertainty and expectations

Long-term challenges

- **Three overlapping shocks with a major economic cost:** 10% of GDP (taking as a reference the projections of the September 2019 *Monetary Policy Report*). If this gap is not closed, the development goal will no longer be achievable for the current generation.
- **Regaining lost ground will not be easy or automatic.** The concentration of the impact of the crisis in some sectors and the effect of social distancing on the modes of work and the required inputs suggests that convergence will not take place at the starting point.
- **It will be essential to face the legacy of the crisis, supporting the reconversion of activities most affected by social distancing;** fully incorporate the digital economy; recover the labor participation of women; reduce labor informality; adapt the financial burden to the capacities of companies and strengthen social protection systems.
- **To face these challenges, the Government will no longer have the same resources.** In a context of low growth, eventual tax and pension reforms will have to devote a good part of their resources only to replacing what was lost.
- **Tapping on new sources of economic dynamism.** The Central Bank has advanced its ambitious medium-term agenda and will continue to do so in the coming months.
- **The constitutional process is an opportunity to build a new political-social pact that generates more solid, reliable and effective institutions** that, along with responding to the needs of the population, can also support innovation, entrepreneurship and productivity.

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