A large, faint background image of a condor in flight, with its wings spread wide, positioned on the left side of the slide.

Unconventional Monetary Policies in Emerging Economies

Pablo García Silva

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Conceptual Framework

- The need for Central Banks to undertake Unconventional Monetary Policies (UMP) arises in circumstances when conventional policies are ineffective to transmit the monetary stance deemed adequate to fulfill statutory mandates (broadly, business-cycle and inflation stabilization, financial stability).
- This ineffectiveness can come from either/or:
 - Overnight interest rates dictated by normative considerations are significantly below the effective lower bound (ELB) for monetary policy implementation.
 - The transmission of monetary stimulus to the real economy is impeded due to a disfunction in the transmission mechanism through the financial/banking system.

Conceptual Framework

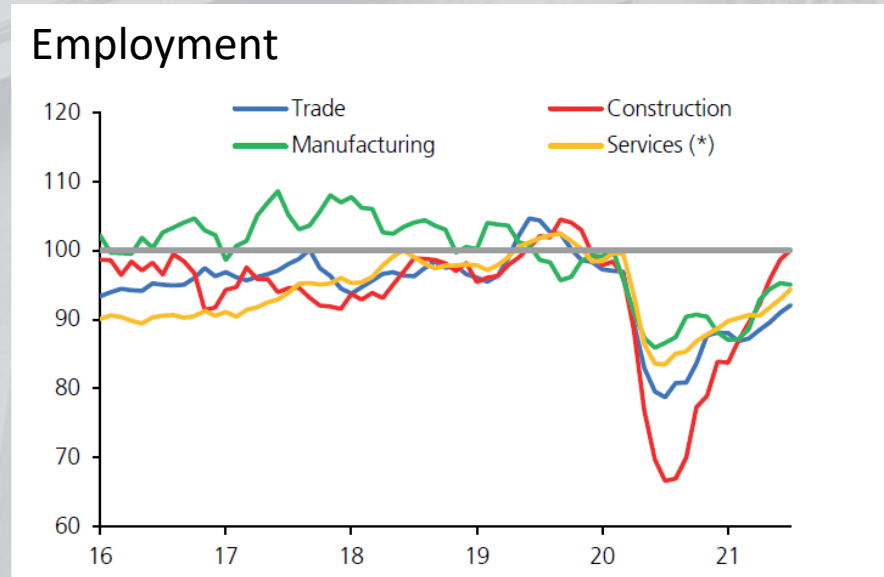
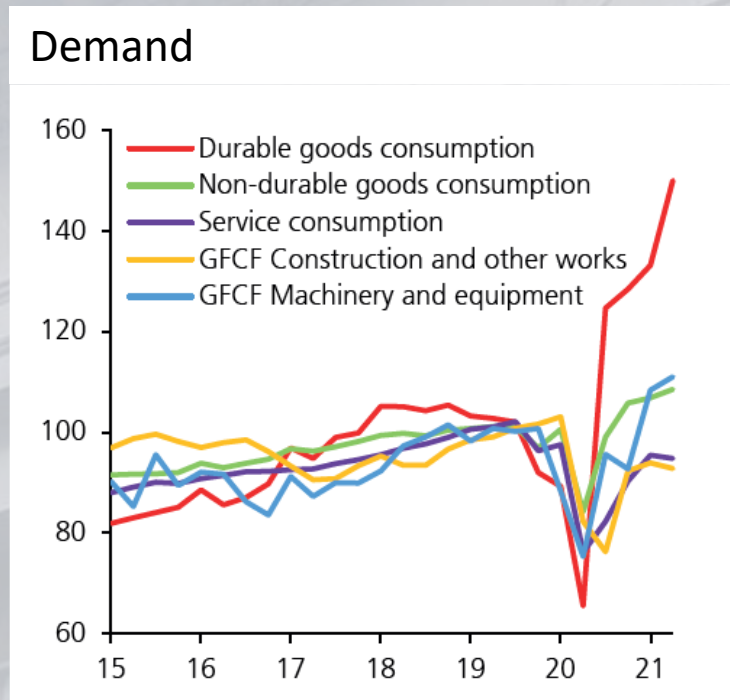
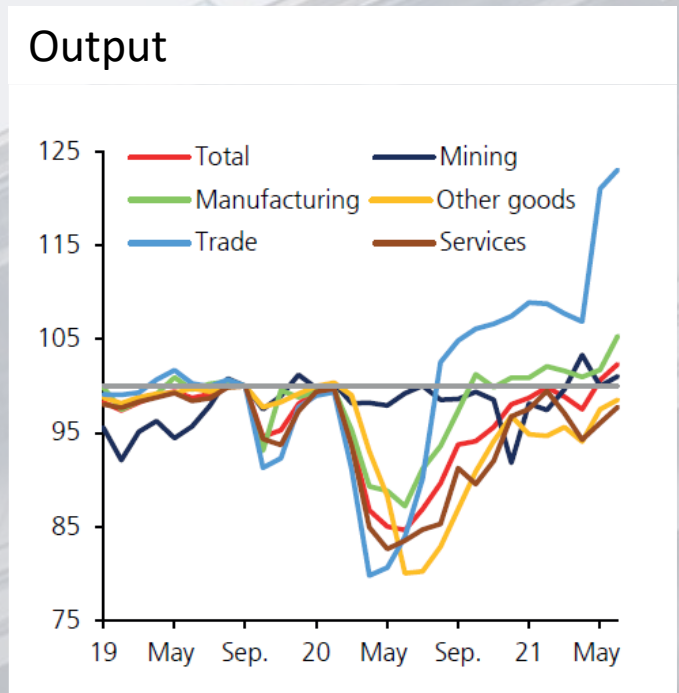
- The nature of the economic shock that creates such circumstances can also be quite diverse. For simplicity it is easier to distinguish between two types of shocks:
 - A significant contraction of effective demand, driven by high uncertainty, precautionary saving, acute tightening of financial conditions, crunch in cash flows, etc....
 - An extraordinary increase in demand for safe/liquid assets, that generates a fire-sale situation in less liquid or more risky financial assets.
 - These two types of shocks interact and feed on each other, dramatically amplifying the economic disruption and wealth redistribution effects of the initial event.

Conceptual Framework

- Why Advanced Economies (AE) and Emerging Economies (EME) could differ in the extent to which they can implement UMPs?
 - Size and structure of the corporate sector, as well as relative importance of banks and capital markets in channeling funding and finance to the corporate sector.
 - Role of capital flows and the current account in the saving/investment equilibrium.
 - Extent of foreign exchange preference by households and firms as a safe and liquid alternative to local currency.
 - Anchoring of inflation expectations and credibility in the conduct of monetary policy.
 - Fiscal soundness and broad institutional credibility.

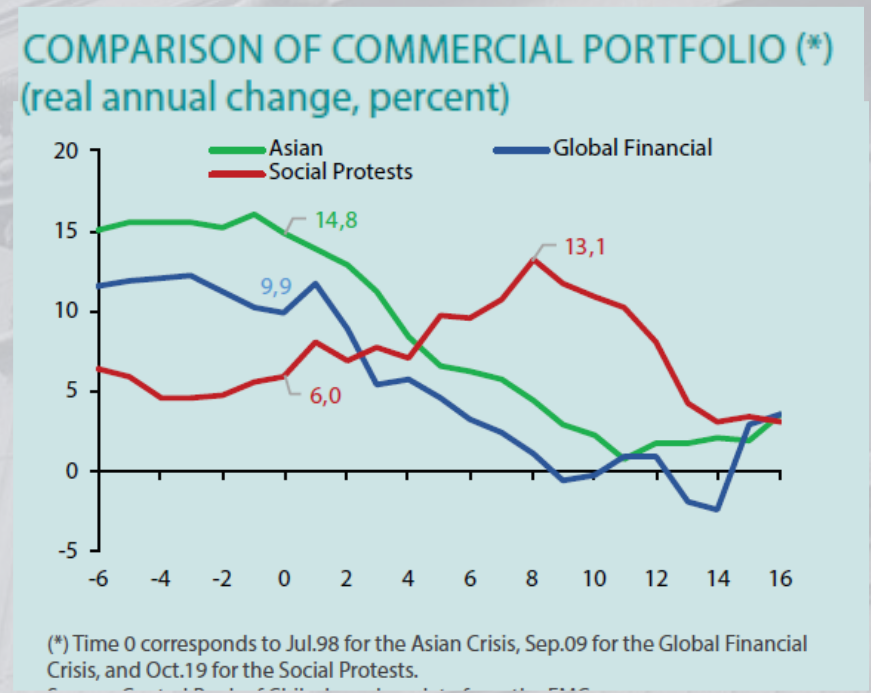
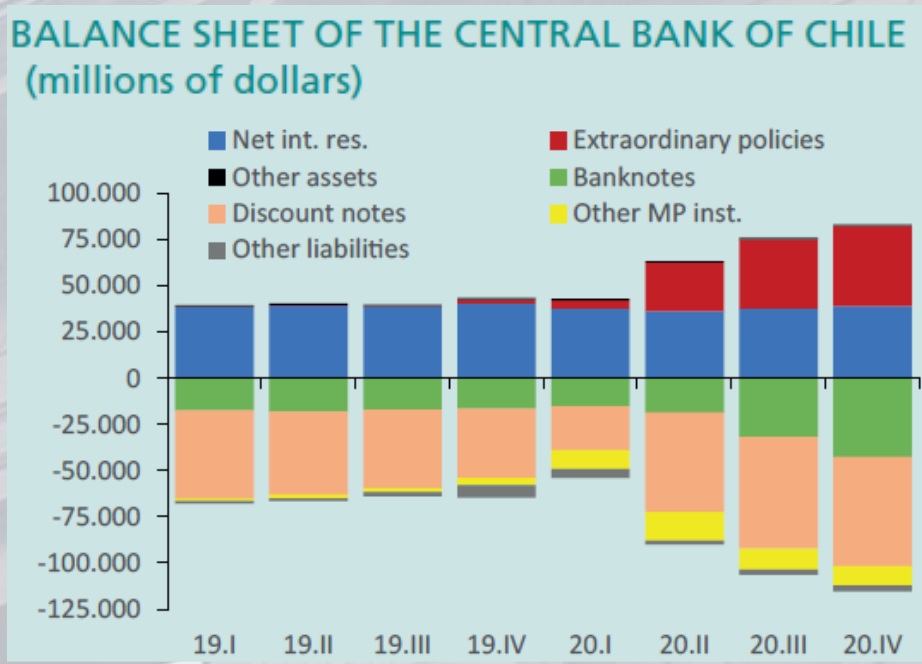
Economic impact of CV19 in Chile

- A large and sudden drop, followed by a rapid recovery to above pre-pandemic levels in some areas:



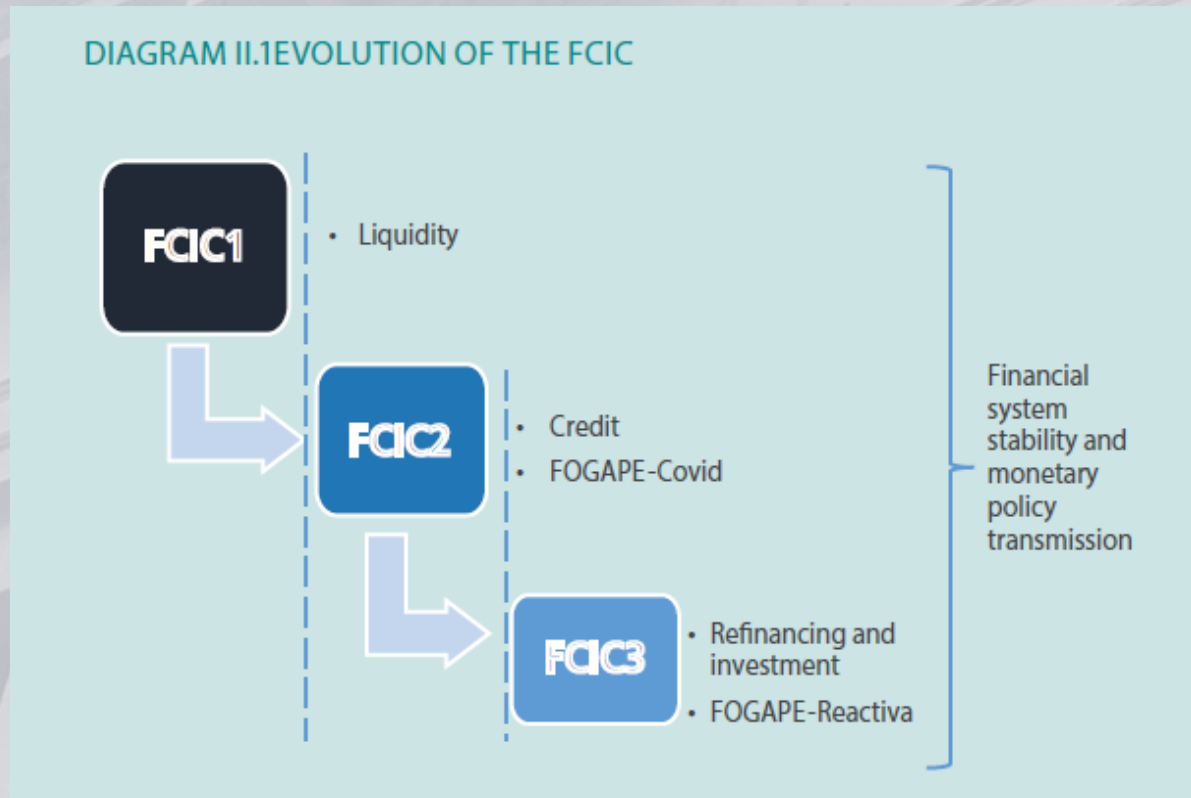
Economic impact of CV19 in Chile

- Implementation of UMPs in Chile recognized the relevance of the bank lending channel to the productive sector. Facilities were tailored accordingly and resulted in a doubling of the size of the CB's balance sheet during 2020 and a countercyclical dynamic of commercial credit:



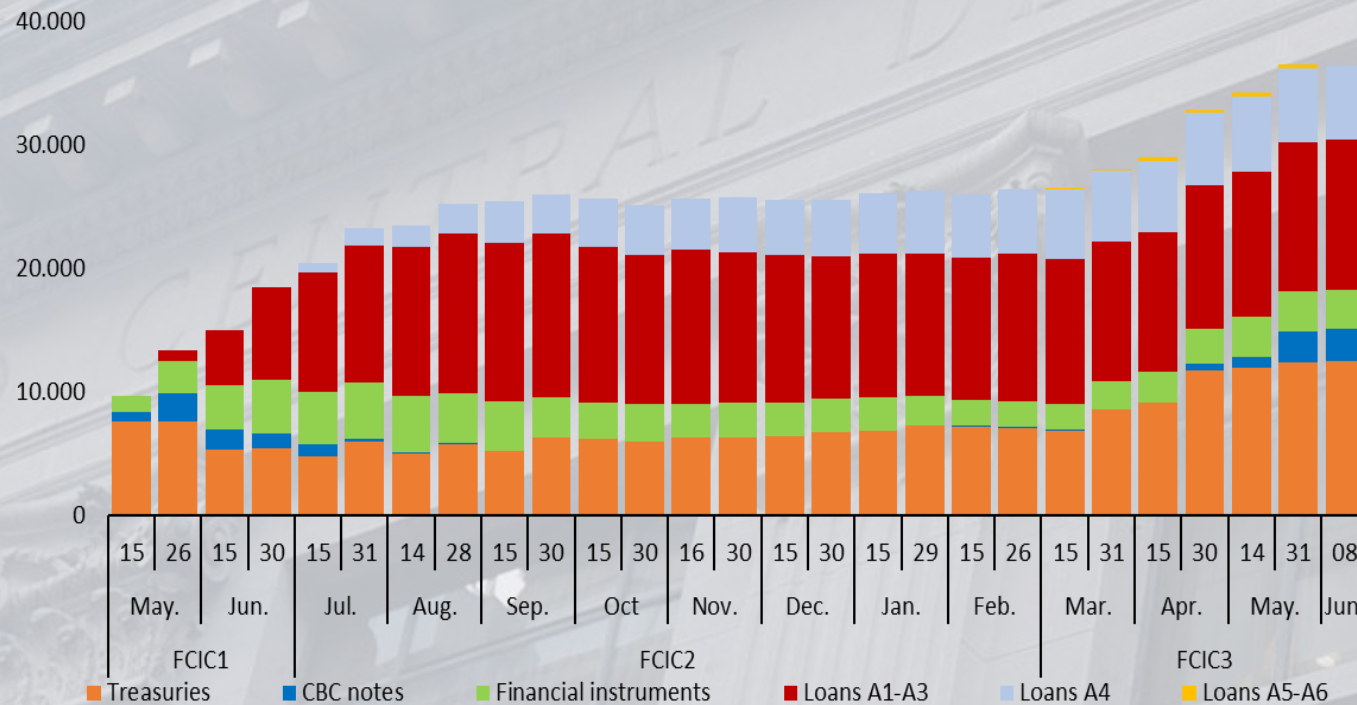
Economic impact of CV19 in Chile

- The main facility was the FCIC: long-term funding to banks at the ELB with a cap conditional on the expansion of commercial credit, and supported by government guarantees on credit losses as well as regulatory waivers. Three tranches were implemented, tailored to the changing circumstances



Economic impact of CV19 in Chile

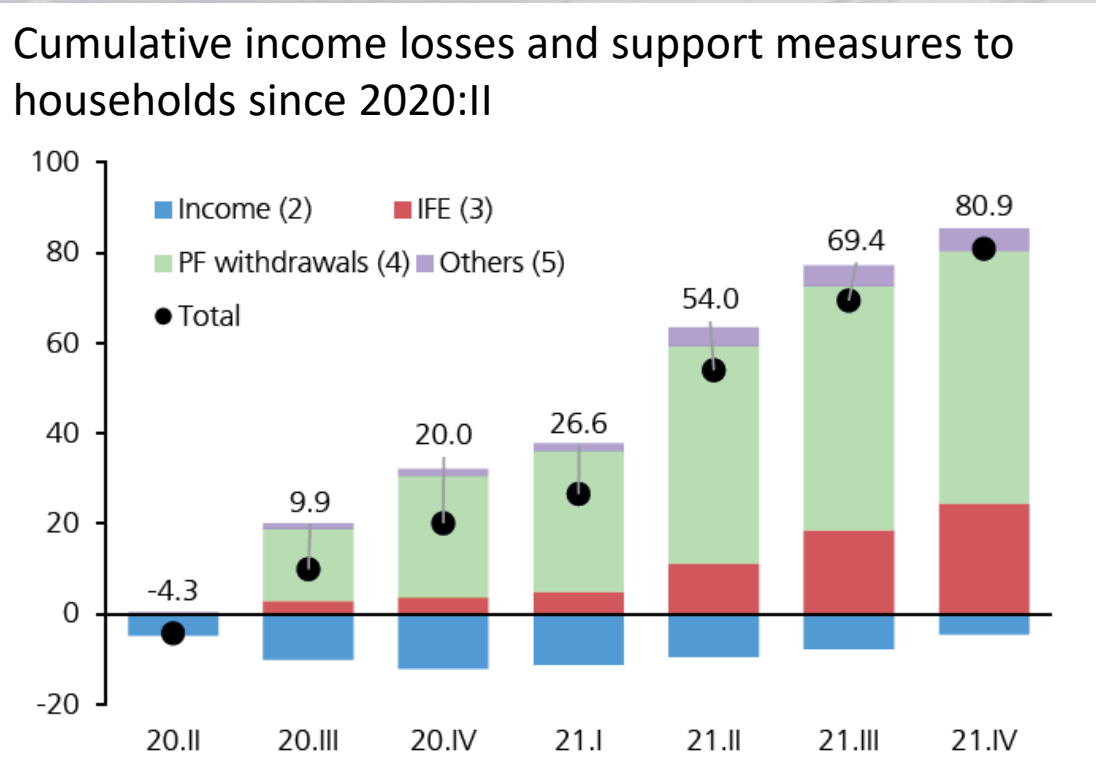
- A significant expansion of eligible collaterals (including commercial loans themselves) was required, which has posed operational challenges:



A# is the risk classification for individual loans. The higher the # the higher the risk. FCIC3 will broaden to A5 – A6 with government guarantees. Magnitudes are in USD millions.

Economic impact of CV19 in Chile

- Pro-cyclical expansion of direct transfers (IFE) and access to pension fund withdrawals have dwarfed income losses by households:



Looking forward

- As the economy has more than recovered from the pandemic (growth is expected around 11% for 2021), to preserve price and financial stability extraordinary measures are being withdrawn:
 - Monetary policy is back in conventional territory, the policy rate has been increased to 2.75% and further hikes are expected going forward.
 - The budget submitted to Congress considers the lapsing of direct transfers.
 - The balance sheet of the Central Bank should evolve according to the natural draw-down of facilities: no explicit taper is considered beyond holding to maturity.

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