Virtual Meeting with Gavea Investments

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Member of the Board

Central Bank of Chile, October 20th 2021

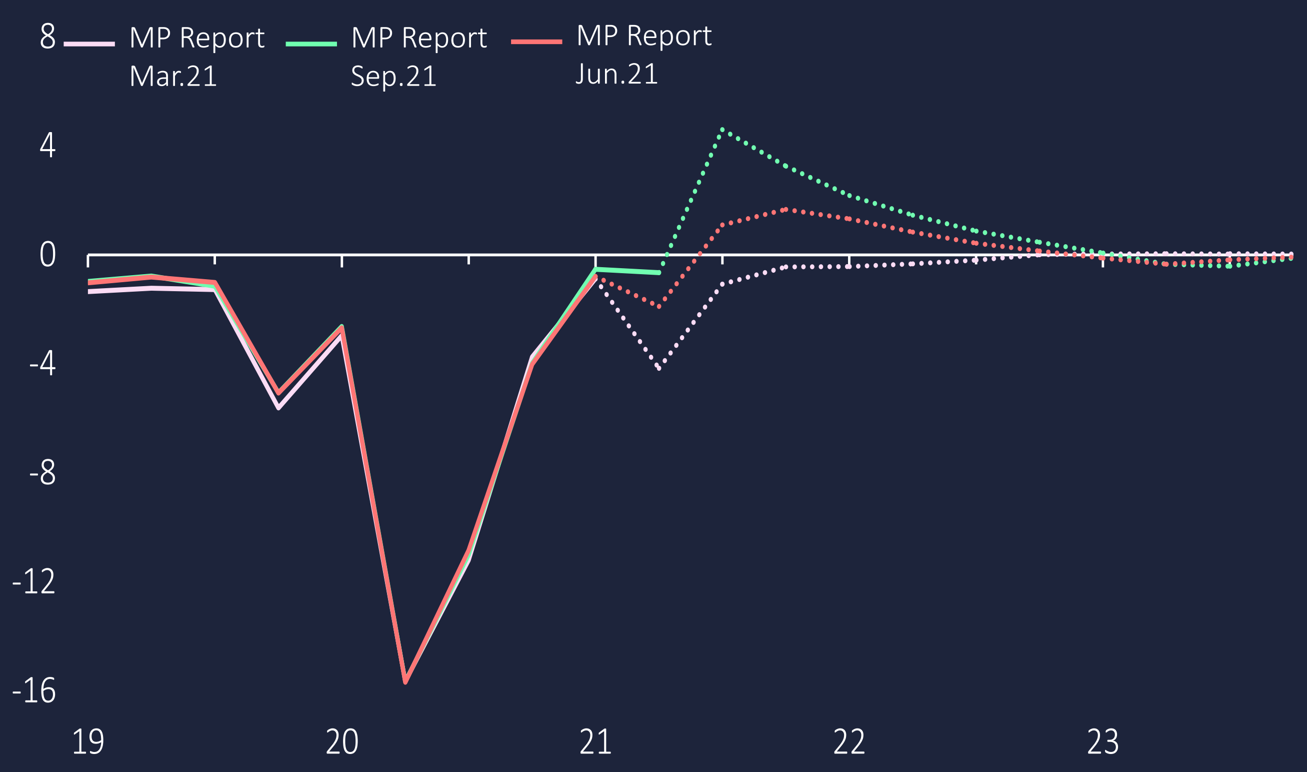
September Monetary Policy Report highlights

What has happened since our last Report?

The strong acceleration of aggregate demand caused the activity gap to close during the second quarter of this year, earlier than expected. The upward revision in activity in 2021 is mainly explained by higher private consumption, followed by public consumption and to a lesser extent by a revised investment outlook.

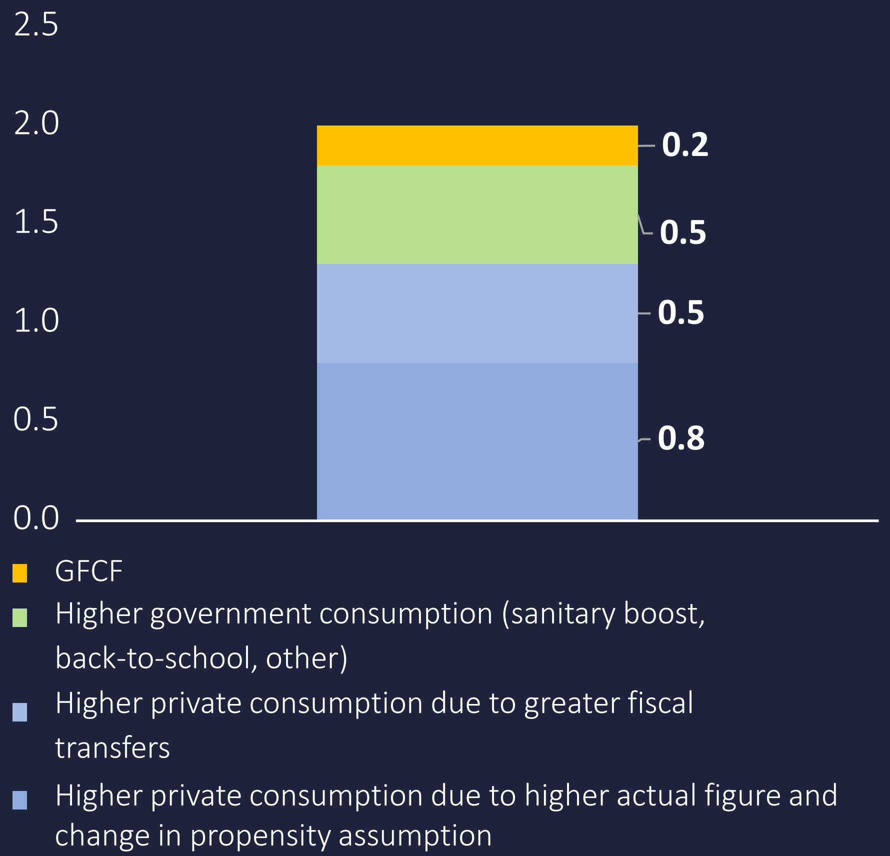
Activity gap (1)

(level, percentage points)



Contribution to revision to 2021 GDP growth (2)

(percentage points)

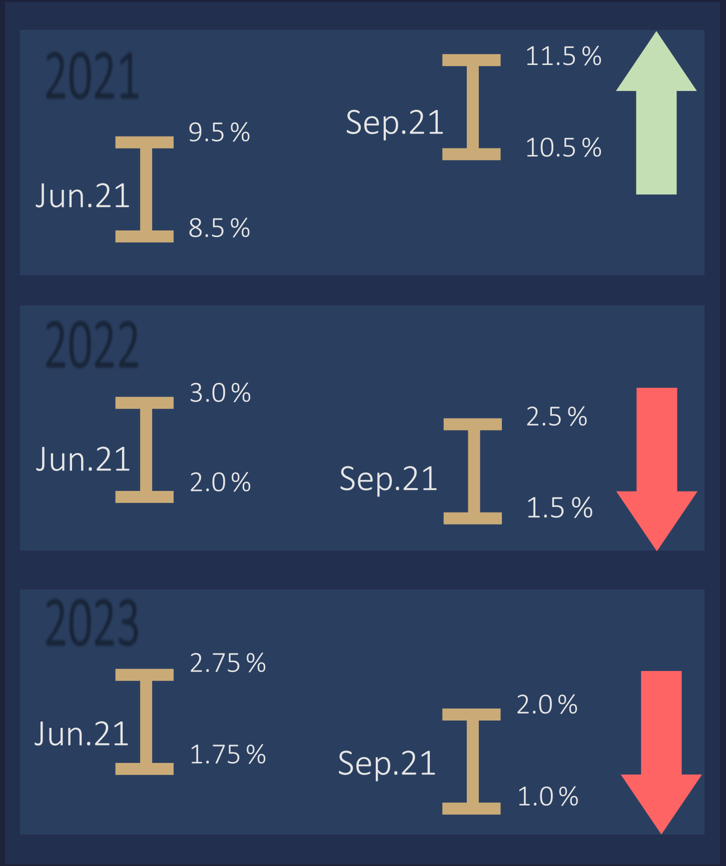


(1) Dotted lines show projections of each *Monetary Policy Report*. The June and September projections use the structural parameters updated in the June 2021 *Monetary Policy Report*. (2) Built considering the midpoint of the *Monetary Policy Report* forecast range of June and September 2021. Source: Central Bank of Chile.

Our central scenario assumed towards 2022 and 2023 the economy will slow down significantly. Consumption should moderate, in line with receding pandemic impacts and reduced economic policy momentum. Investment recovery is still expected to be sluggish, due to idiosyncratic headwinds.

GDP growth forecast

(annual change, percent)

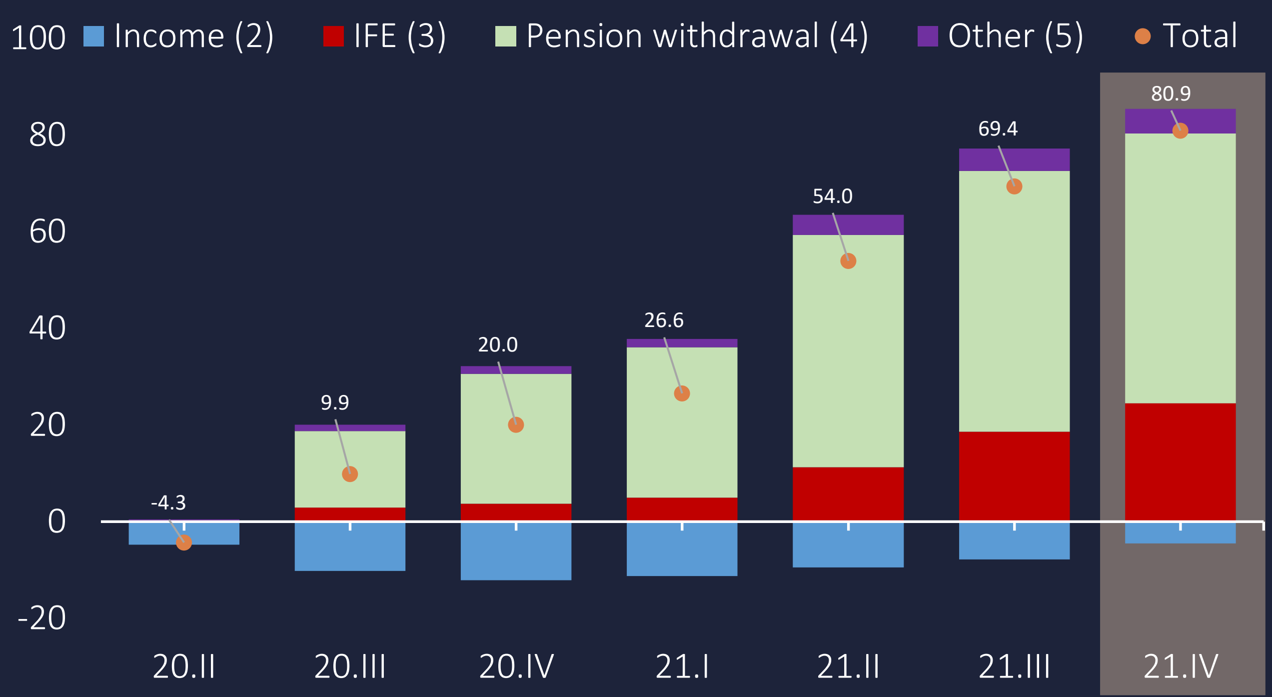


	2020	2021 (f)		2022 (f)		2023 (f)	
		MPR Jun.21	MPR Sep.21	MPR Jun.21	MPR Sep.21	MPR Jun.21	MPR Sep.21
GDP	-5.8	8.5-9.5	10.5-11.5	2.0-3.0	1.5-2.5	1.75-2.75	1.0-2.0
Domestic demand	-9.1	15.5	18.5	1.5	0.9	1.6	0.5
Domestic demand (w/o inventory change)	-7.9	13.3	16.7	1.7	0.5	1.4	0.2
Gross fixed capital formation	-11.5	11.4	15.9	3.2	0.3	2.0	0.6
Total consumption	-6.8	13.8	16.9	1.3	0.5	1.2	0.1
Private consumption	-7.5	15.1	18.1	1.3	1.1	1.0	-0.4
Goods and services exports	-1.0	1.1	0.1	5.4	5.7	4.2	5.0
Goods and services imports	-12.7	23.2	24.6	2.7	2.3	2.5	1.8
Current account (% of GDP)	1.4	-0.8	-2.2	-1.1	-2.1	-1.9	-2.3

(f) Forecast. Considers midpoint of growth ranges contained in *Monetary Policy Reports* of June and September 2021. Source: Central Bank of Chile.

The sum of the demand stimulus has far outweighed the fall in household income.

Households' cumulative income and liquidity injections (1)
(billions of dollars)

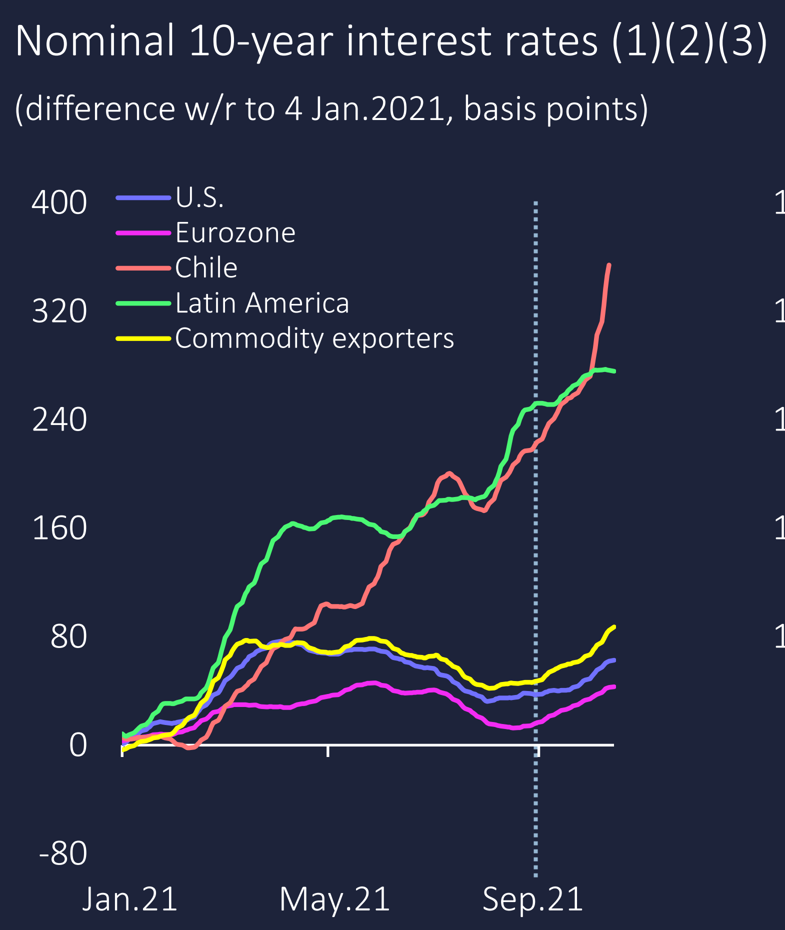


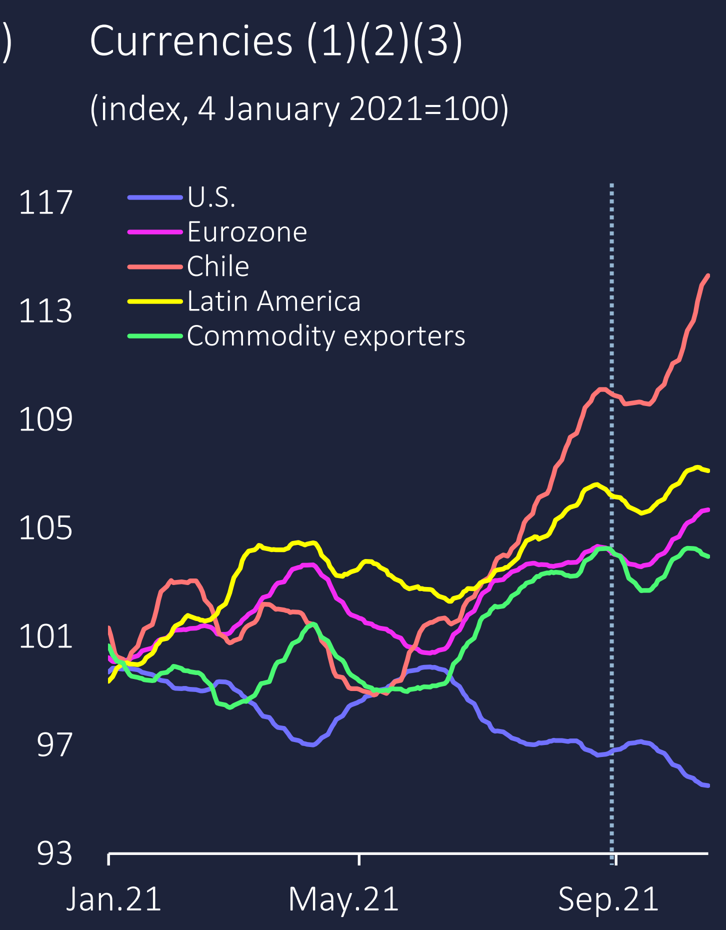
For the latter part of the year, new income transfer programs to households and higher consumer spending on healthcare were incorporated, reinforcing the stimuli to demand considered in the June report.

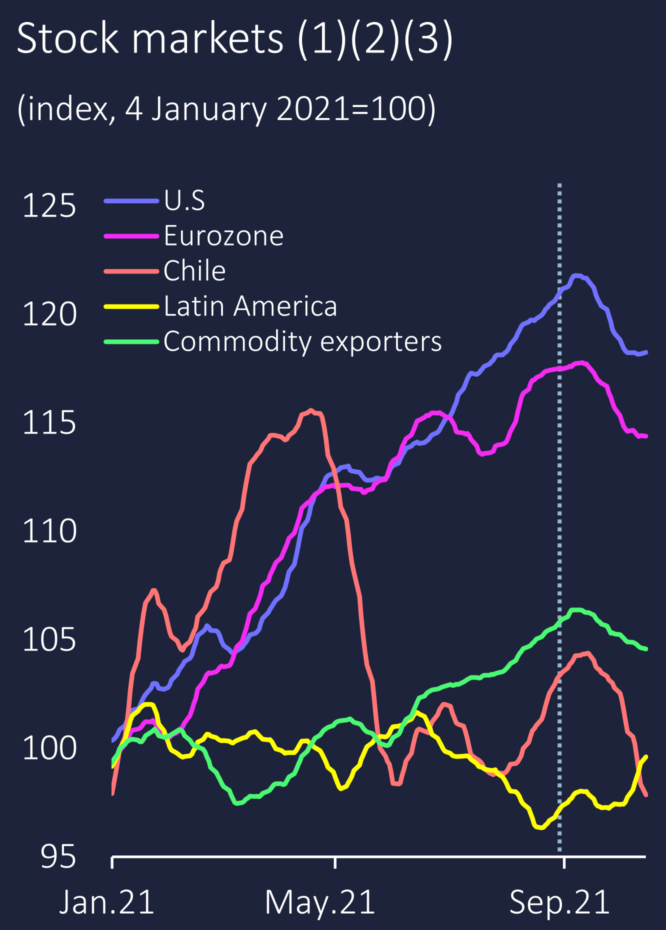
We assumed that the temporary fiscal stimulus programs will be withdrawn in 2022 and that there is no fourth withdrawal of pension funds.

(1) Households' increase in liquidity and support measures from 21.II to 20.IV are estimated based on forecasts consistent with the central scenario. (2) Sum of work income and other earnings (production rents and property rents CNSI). Quarterly values are differences with same quarters of 2019. (3) IFE has grown in amounts and coverage, from over 6 million average recipients between May 20 and March 21, to more than 15 million in July 21. Amounts per capita have risen from US$70 in the beginning to US$200 in July 21. For Aug 21 and Sept 21, figures are based on Public Finances Report No.79, Dipres (06-02-2021).For Oct 21 and Nov-21 there is also Universal IFE of US$3.2 billion in each month (4) Amounts paid based on statistic charts of the Pension Superintendency at 30 July 2021. For 21.III and 21.IV difference weighted between estimated total amounts to withdraw and effectively paid at 30 July 2021. (5) Considers Covid-19 bonus, middle-class bonus, 3rd pension withdrawal, and additional use of Unemployment Insurance and workers IEF. Sources: Finance Ministry of Chile, Superintendency of Pensions (SP), and Central Bank of Chile.

The financial market has reacted to the higher local risks with a higher exchange rate, higher long-term interest rates and relative penalties in the stock market. Since the last MP Report these trends have deepened.





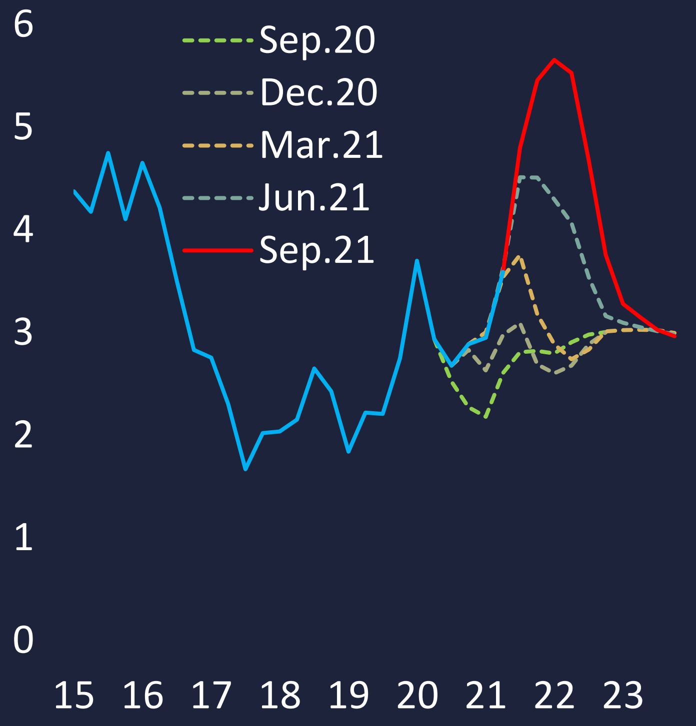


(1) 15-day moving average. (2) For Latin America, the simple average of the indexes of Brazil, Colombia, Mexico and Peru are used. For commodity exporters, the simple average of the indexes of Australia and New Zealand are used (3) Dashed vertical line marks September 2021 Report. Sources: Central Bank of Chile and Bloomberg.

The impact on inflation was significant, and although there were transitory elements, it had a relevant degree of persistency. The upward revision of inflation was mainly explained by higher private consumption and by an idiosyncratic depreciation that also contributes.

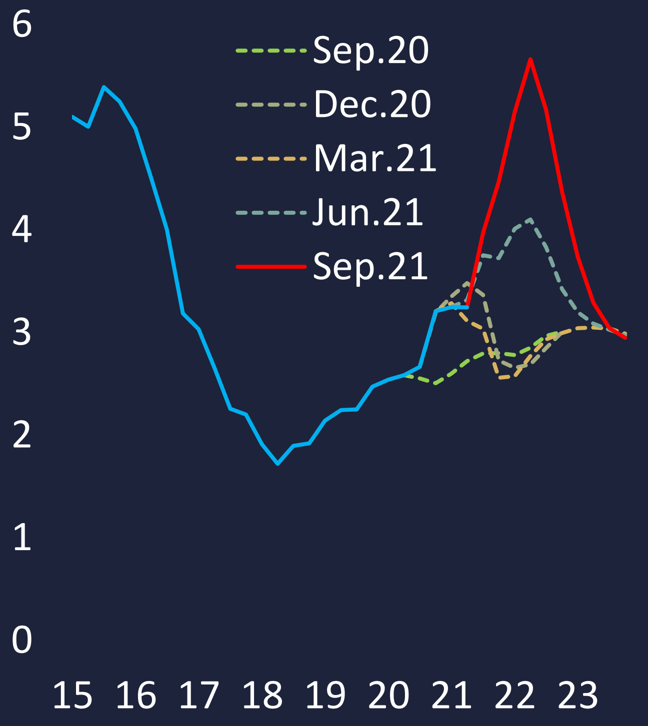
Inflation forecasts: Headline CPI (1)

(annual change, percent)



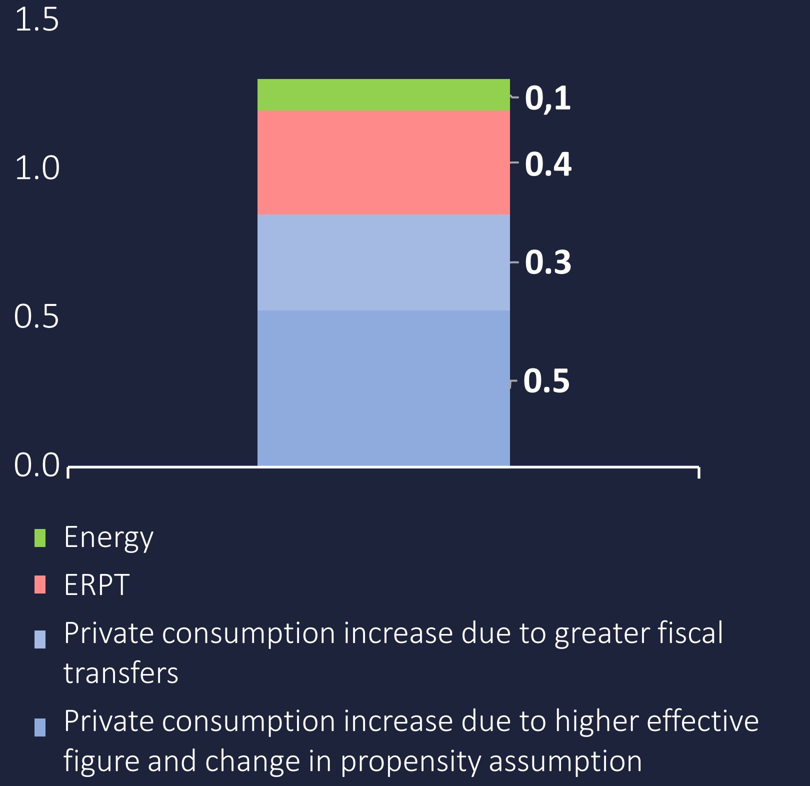
Inflation forecasts: Core CPI (1) (2)

(annual change, percent)



Contribution to revision to inflation forecast in December 2021 (3)

(percentage points)



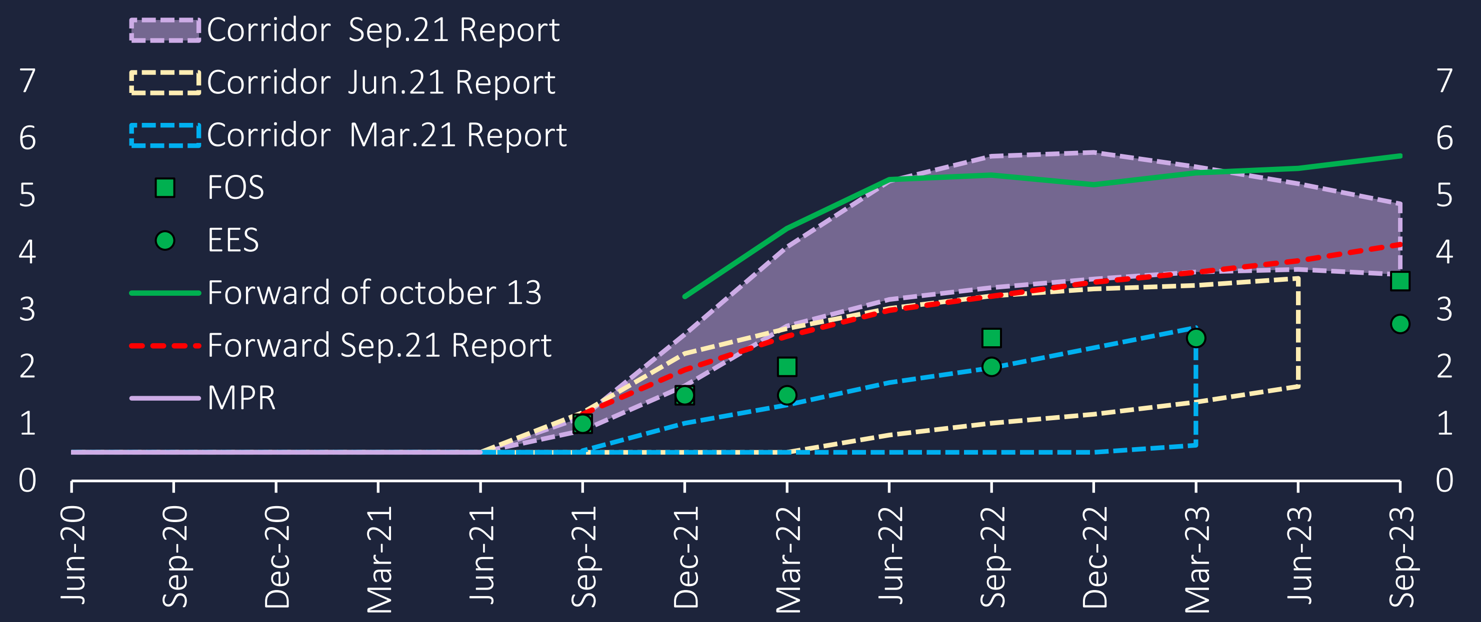
(1) Dashed lines indicate forecast in respective *Monetary Policy Report*. (2) Measured by CPI without volatiles. Sources: Central Bank of Chile and National Statistics Institute.

(3) Built using the projections for total CPI inflation from the *Monetary Policy Reports* of June and September 2021. Sources: Central Bank of Chile and National Statistics Institute

In this context, we raised the MPR to 1.5% in August (+75bp), after raising it by 25bp in July, and anticipate that we will continue to withdraw the monetary impulse, bringing the MPR at levels similar to its neutral towards the middle of the first semester of 2022.

MPR corridor (*)

(percent)



(*) The corridor is built following the methodology of Box V.1 of the March 2020 *Monetary Policy Report*. It includes the FTS of August 26, the EES of August 10, the quarter's mean smoothed forward curve (statistical cutoff and October 13). The methodology corresponds to the extraction of the implicit MPR considering the forward curve on the interest rate swap curve up to 2 years, discounting the fixed rates for each term at the simple accrual of the CPI.
Source: Central Bank of Chile.

We considered there were sensitivity scenarios that might require monetary policy action somewhat different from those envisioned in the central scenario.

Sensitivity scenarios

Scenario 1: Possible reasons

Less Dynamic consumption because of:

- Pandemic resurgence
- Current dynamism could be due to anticipated demand
- Reduction in domestic uncertainty

Implications:

- Reduced inflationary pressures

More gradual contraction of monetary stimulus

Scenario 2: Possible reasons

Slower reduction in public spending:

- Higher inflation in developed economies
- Greater than expected consumption

Implications:

Higher inflationary pressures

Amplified impacts on local financial market

More vigorous monetary policy response

Risk scenarios: changes in the economy that would require a policy response beyond the limits of the MPR corridor

1: Lack of clarity about the long-term stabilization of public finances

- Increased spending pressures and amplified impacts on the local financial market,
- Implies a more accelerated increase in the MPR, despite which inflation does not converge to the target over the policy horizon.

2: Approval of new pension fund withdrawals

- More dynamic consumption and greater pressure on prices,
- Even greater impact on the financial system, increasing the cost of indebtedness, capital outflows and strong accumulation of funds in USD,
- The probability of its materialization could already be affecting the behavior of economic agents.

→ No central bank has the powers, instruments, or resources to neutralize these risks and restore macroeconomic equilibrium.

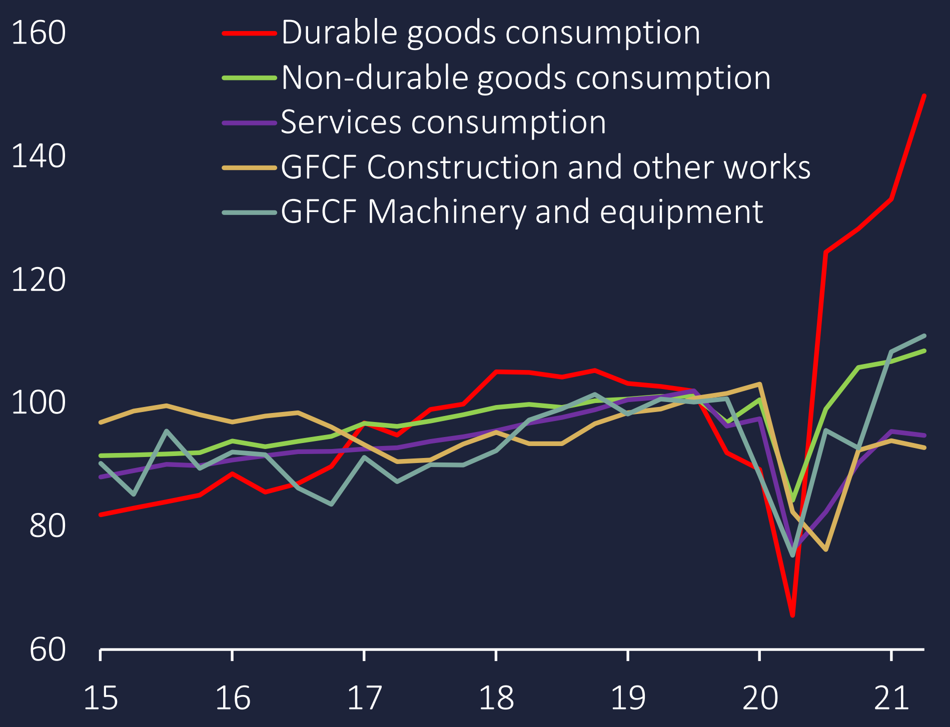
September Monetary Policy Report highlights

What has happened since our last Report?

Demand recovery was extraordinarily driven by consumption, especially in durable goods, while the recovery of investment, somewhat less strong, has been led by machinery and equipment.

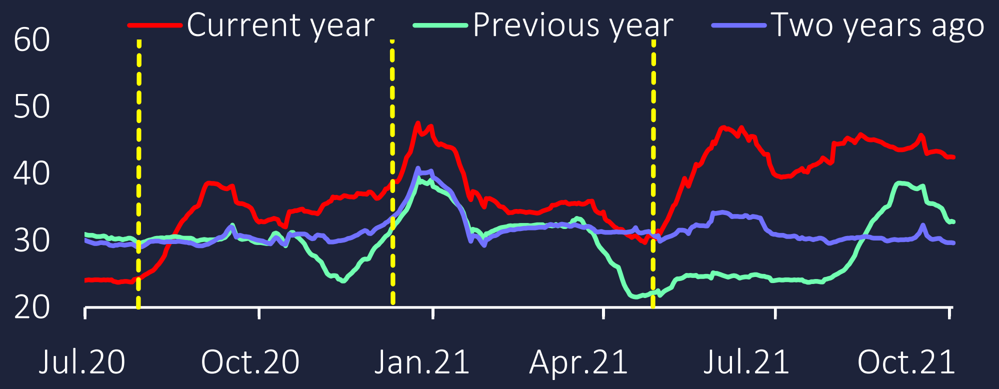
Domestic demand

(seasonally-adjusted series, index, September 2019=100)



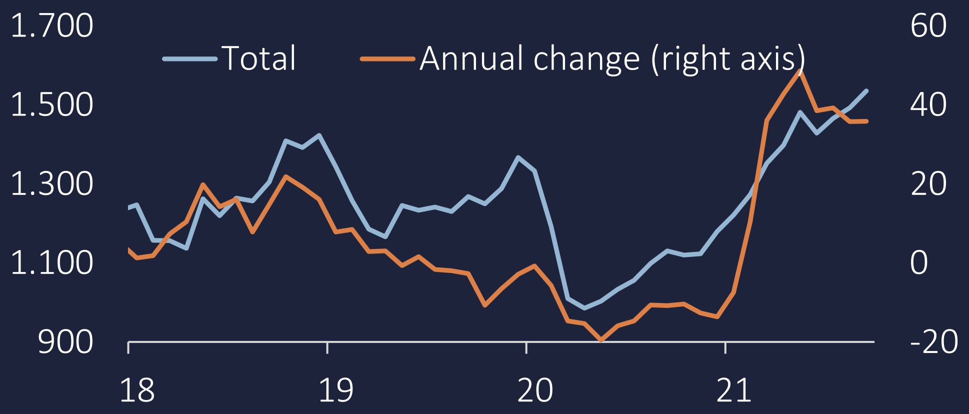
Retail sales with digital invoicing (1)

(billions of CLP, 28-day moving average)



Imports of capital goods (2)

(million of dollars, percent)

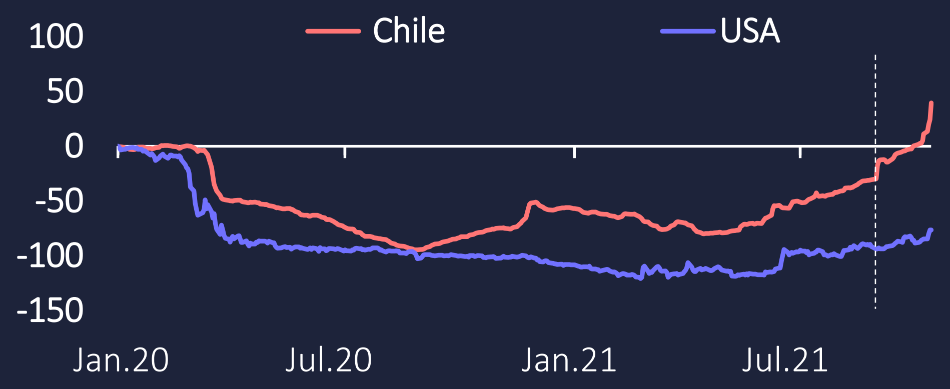


(1) Yellow vertical lines show approvals to pension fund withdrawals. (2) Three-months moving average. Sources: Central Bank of Chile and SII data.

Domestic factors explain the increase in long interest rates and the exchange rate depreciation, especially after the third withdrawal of pension funds.

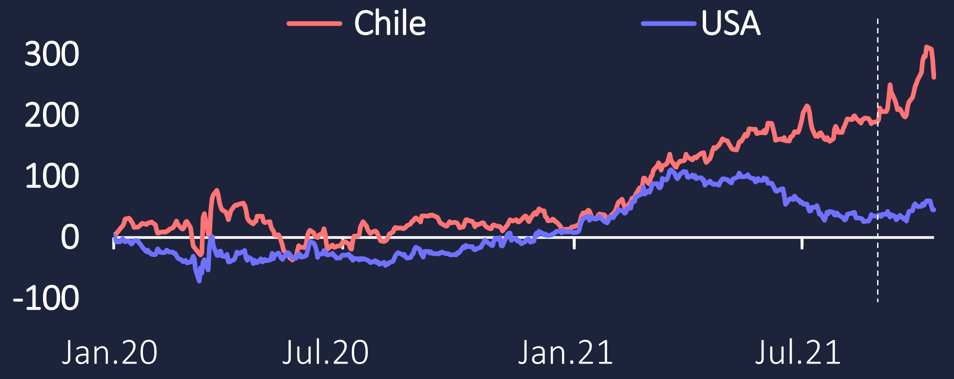
10-year risk neutral rate (1)

(change compared to 12/30/2019, basis points)



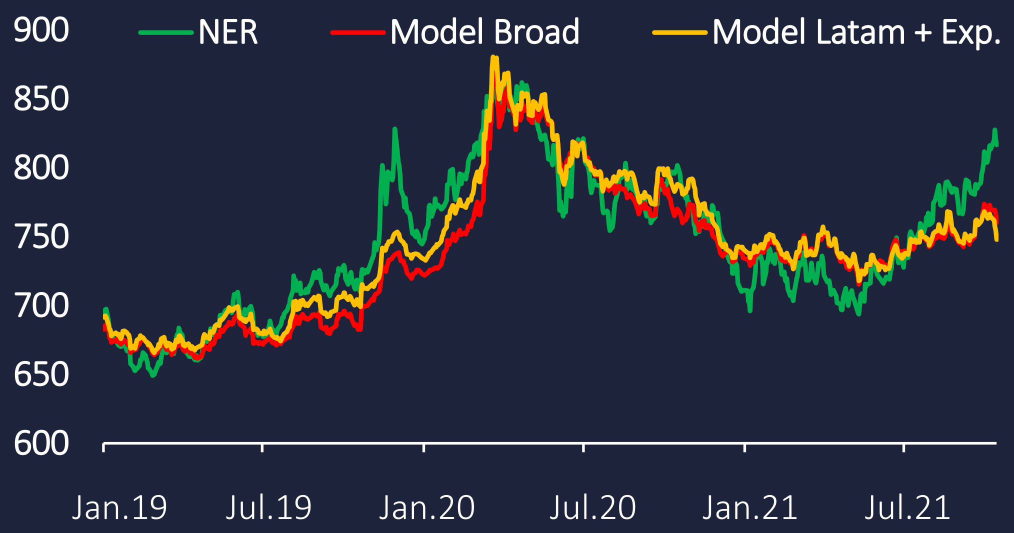
10-year term premium (1)

(change compared to 12/30/2019, basis points)



Nominal foreign exchange rate (1) (2)

(CLP/USD, daily data)



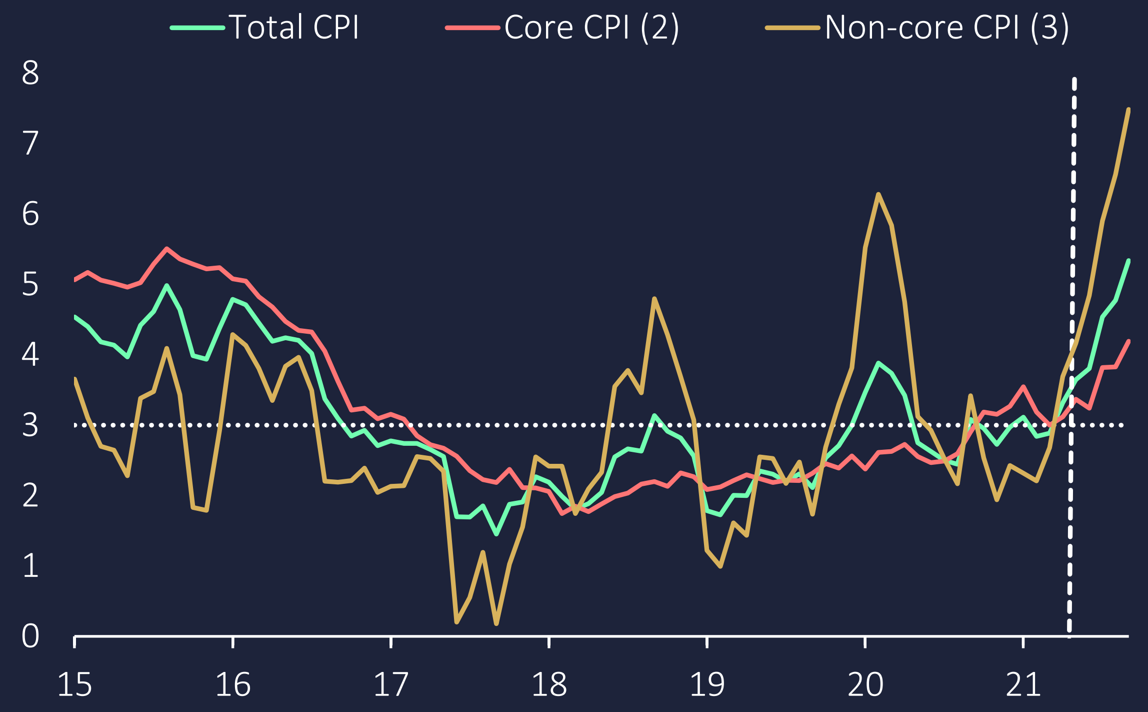
(1) Vertical lines correspond to Monetary Policy Report September 2021.(2) Last observation: 15/Oct/21.

Sources: Central Bank of Chile, Bloomberg and New York Fed.

In September, the annual variation of the CPI rose to 5.3%, outweighing expectations, while its core part accumulated an annual increase of 4.2%, close to the forecast in the September Monetary Policy Report. The increase of recent months has affected every item in the CPI basket, reflecting inflationary pressures on both the demand and the cost side, as well as the sharp depreciation of the peso.

Inflation indicators (1)

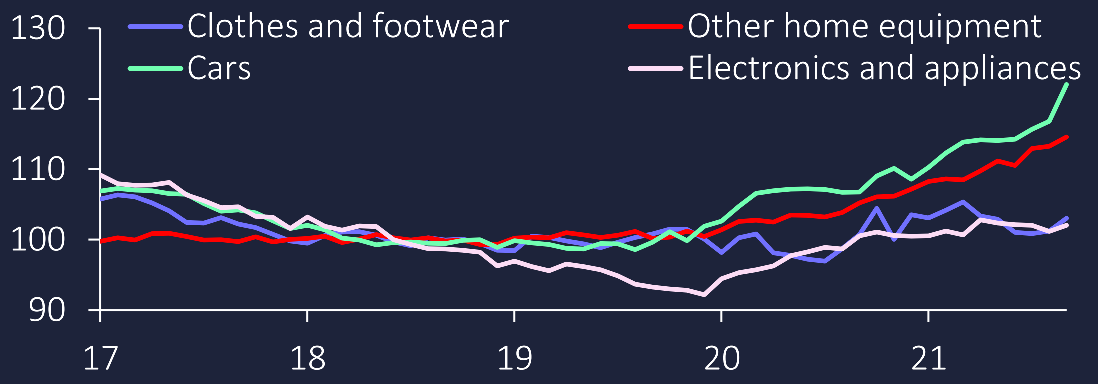
(annual change, percent)



(1) Dashed vertical line marks statistical cut-off of June 2021 Report. (2) Measured using CPI without volatile items, wich represents 65.1% share in the total CPI basket. For more details, see Box IV.1 in December 2019 Report y Carlomagno and Sansone (2019). (3) Measured using volatile CPI items, wich represents 34.9% share in the total CPI basket. (4) Shows evolution of CPI sub-indexes of respective categories. (5) In parentheses, share in total CPI basket. Sources: Central Bank of Chile and National Statistics Institute (INE).

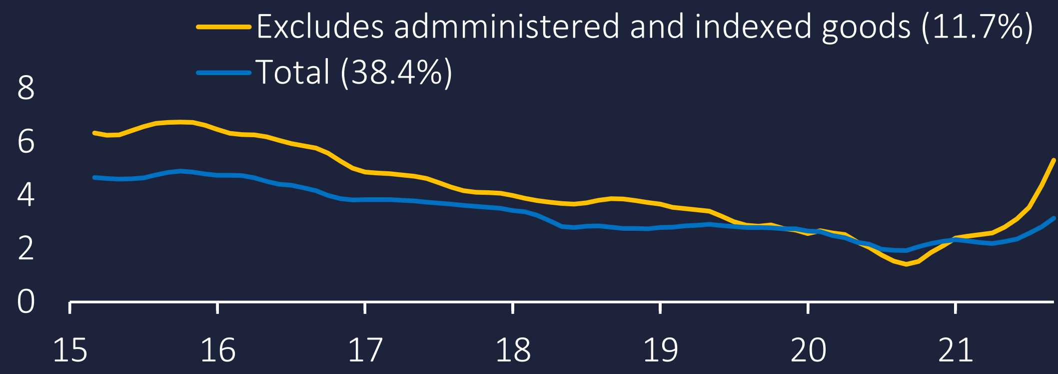
Goods facing high demand (4)

(index, 2018 base=100)



Services CPI w/o volátiles (5)

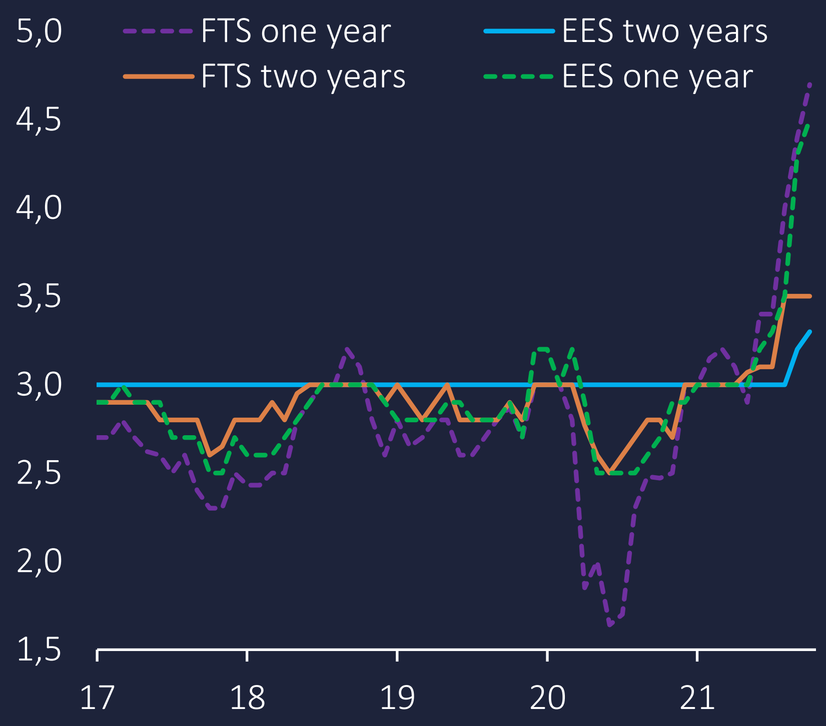
(annual change, 3-month moving average, percent)



Inflation expectations have risen in all horizons. In the immediate term, some measures exceed the forecasts in the September MP Report, going past 6% for the end of this year. Two years ahead, the median of the EES and of the Financial Traders Survey (FTS) has risen and remains above 3% annually.

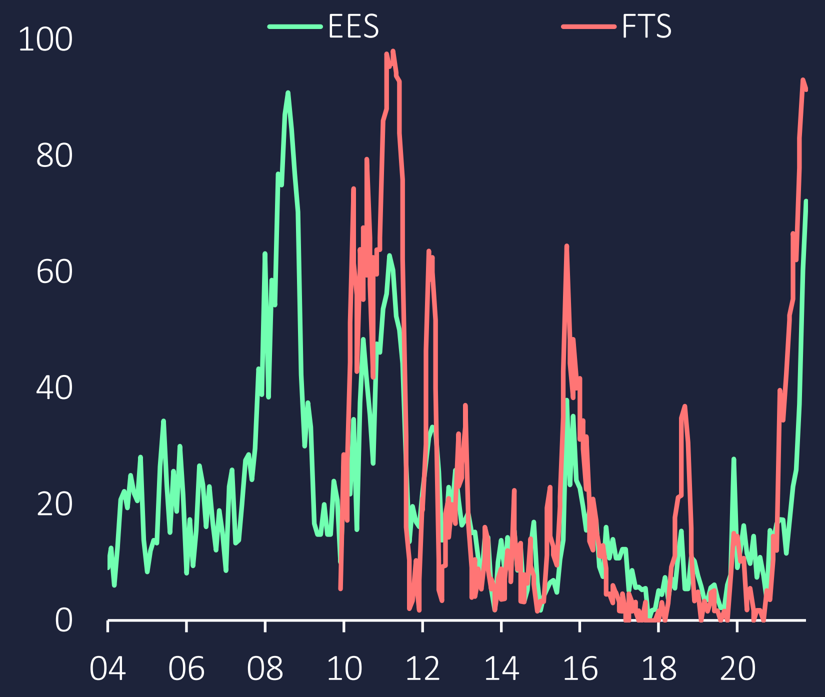
Expectations in surveys (*)

(annual change, percent)



Surveys: Expectations above 3% 2 years ahead (*)

(percent of responses)

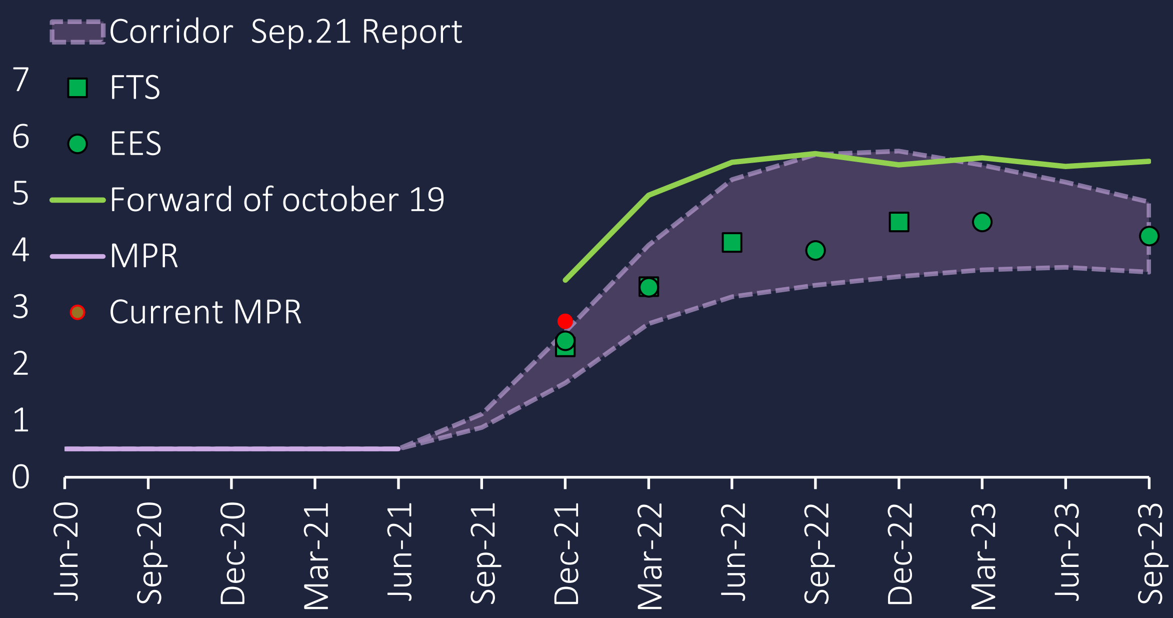


(*) Economic Expectations Survey (EES). Financial Traders Survey (FTS). The FTS considers the survey of the first half of each month up to January 2018. From February 2018 onwards, it uses the last survey published in the month. In the months where no survey is published, the last available survey is used.
Sources: Central Bank of Chile, ICAP, and Tradition Chile.

In our last meeting we decided to anticipate the withdrawal of the monetary stimulus and rose the MPR to 2.75%. We also said that we are going to meet the neutral rate level earlier than foreseen in the central scenario of September's Report.

MPR corridor (*)

(percent)



(*) The corridor is built following the methodology of Box V.1 of the March 2020 *Monetary Policy Report*. The methodology corresponds to the extraction of the implicit MPR considering the forward curve on the interest rate swap curve up to 2 years, discounting the fixed rates for each term at the simple accrual of the CPI. For reference, the chart includes the FTS of October 7, the EES of October 13 and the quarter's mean smoothed forward curve (October 19). Source: Central Bank of Chile.

The CBC Board decided to intensify the withdrawal of monetary stimulus to avoid the accumulation of macroeconomic imbalances that could jeopardize the convergence of inflation to the 3% target.

This is so because a scenario has emerged in which the CBC Board has less room for maneuver, as a result of:

1. Rapid evolution of macroeconomic scenario
2. Inflation expectations dynamics
3. Sensitivity scenarios associated with higher pressures on prices

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