

MONETARY POLICY REPORT

JUNE 2021

ROSANNA COSTA, MEMBER OF THE BOARD



What does this MP Report tell us?



The Chilean economy has outperformed expectations, reflecting the strong macroeconomic momentum and the agents' better adaptation to the sanitary constraints. This, in the context of somewhat more favorable external conditions, especially due to the evolution of the terms of trade.



Private consumption has risen strongly, fueled by pension savings withdrawals and massive fiscal transfers. In addition, new reforms have already been approved that will provide significant temporary boosts to expenditure.



The better recent performance combined with the increased spending impulse, in a context of more favorable external conditions, lead to a significant correction in this year's projected growth, although medium-term growth is revised downwards.



Even with these advances, the general perception remains marked by the evolution of infections and quarantines, the significant backwardness of some sectors, the fragilities in the labor market and the persistence of high uncertainty.

What does this MP Report tell us?



The local financial market has reacted to these developments, decoupling with respect to the global trends. Long rates have risen while their external counterparts have been fairly stable, the stock market has fallen, and sovereign risk has seen a moderate increase.



The higher growth rate expected for 2021 will bring the closing of the wide activity gap forward, so the monetary impulse should begin to moderate sooner than was expected in the last MP Report.



Even so, in the central scenario, the MPR is expected to be held below its neutral level throughout the policy horizon, underpinning a recovery process that will continue to endure significant challenges.

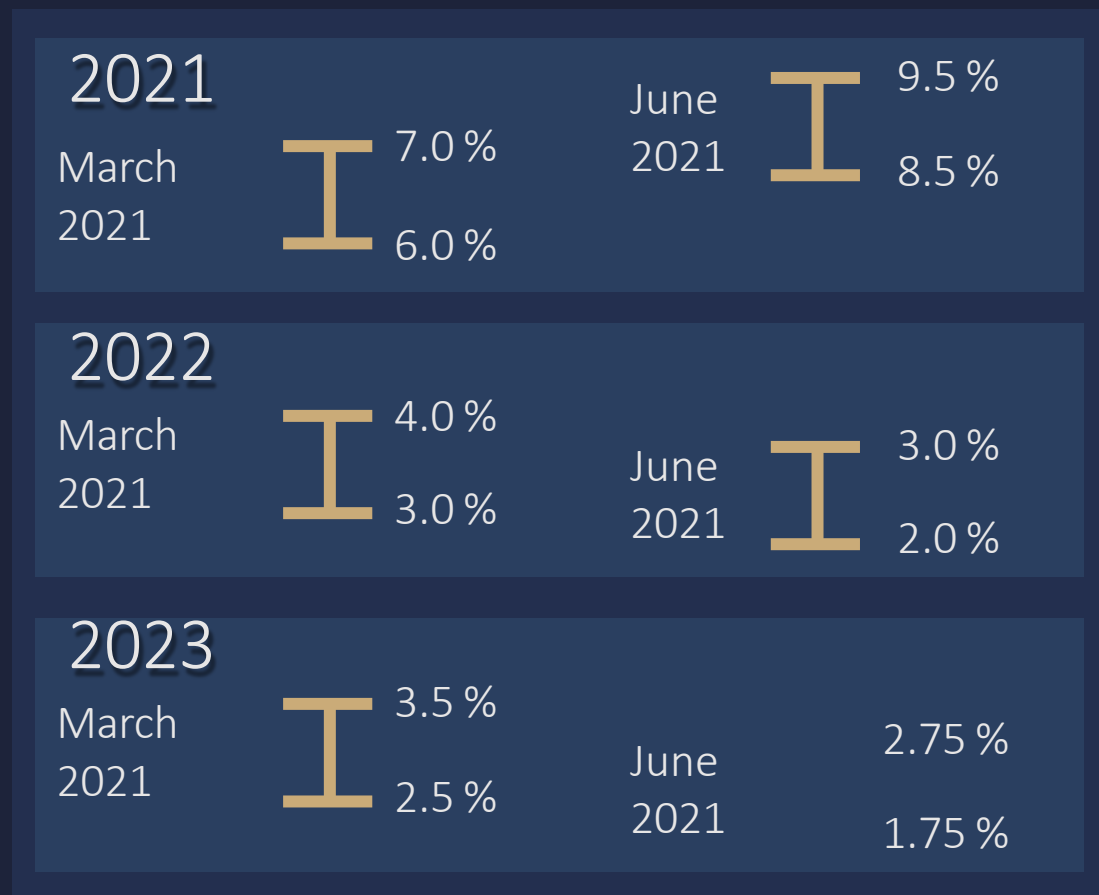


For this Report, the Board updated the structural parameters of the economy. In particular, it acknowledges a downward trend in total factor productivity that leads to a reduction in trend growth. Also, we reduce in neutral rates.

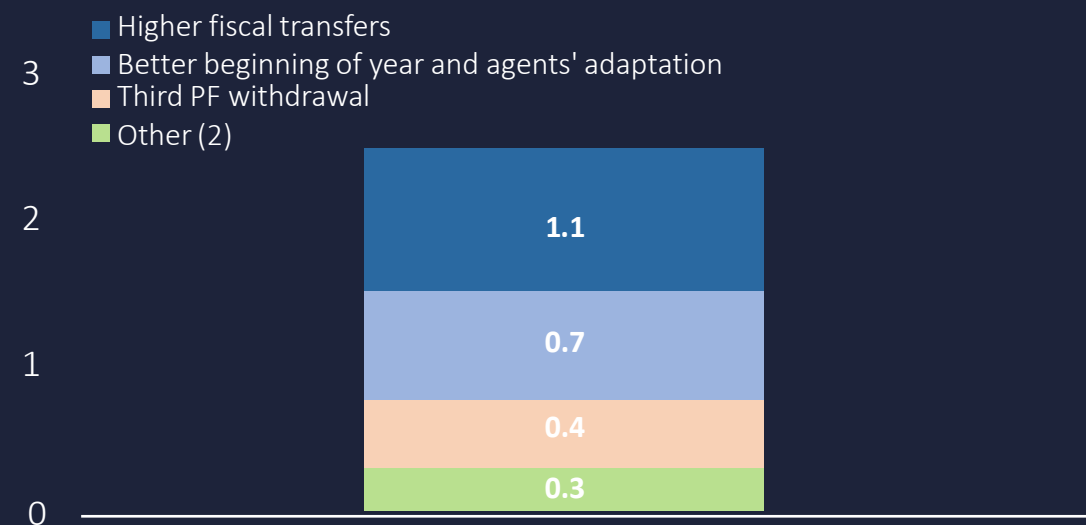
Outlook for this year assumes significant upward adjustment with respect to March MP Report.



GDP growth forecasts (annual change, percent)



Contributions to 2021 GDP growth revision (1) (percentage points)



Downward correction in 2022-2023 due to higher comparison base, gradual extinction of consumer-impulse measures, and limited investment dynamism.

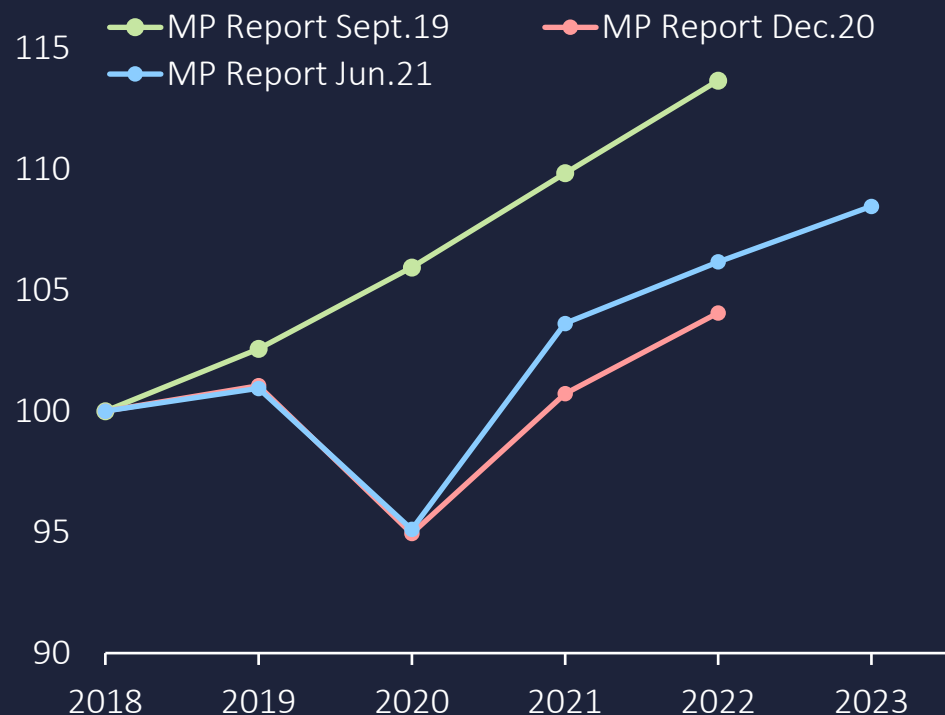
(1) Built considering midpoint of forecast range in March and June 2021 MP Reports (2) Includes external and mining sectors. Source: Central Bank of Chile.

All in all, the level of economic activity is still below the September 2019 forecast.



GDP forecasts

(index, 2018 = 100)



Economic growth and current account

(annual change, percent)

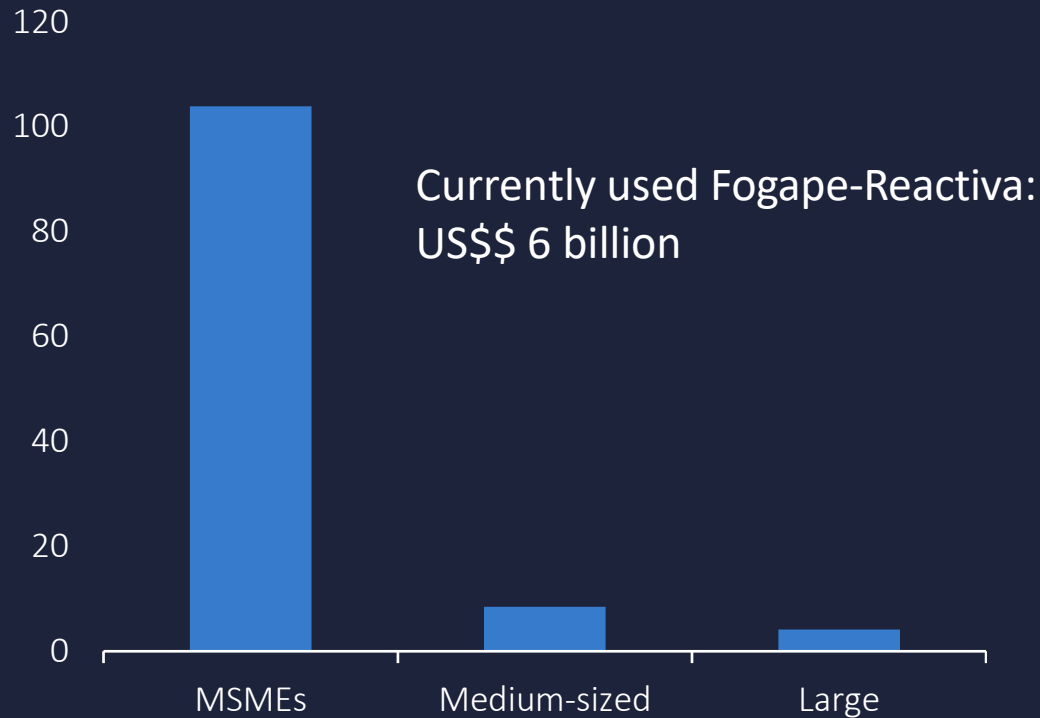
	2020	2021 (f)		2022 (f)		2023 (f)	
		MP Report Mar.21	MP Report Jun.21	MP Report Mar.21	MP Report Jun.21	MP Report Mar.21	MP Report Jun.21
GDP	-5.8	6.0-7.0	8.5-9.5	3.0-4.0	2.0-3.0	2.5-3.5	1.75-2.75
Domestic demand	-9.1	11.7	15.5	3.1	1.5	2.7	1.6
Domestic demand (w/o inventory change)	-7.9	11.0	13.3	2.8	1.7	2.8	1.4
GFCF	-11.5	9.2	11.4	4.9	3.2	3.3	2.0
Total consumption	-6.8	11.5	13.8	2.2	1.3	2.7	1.2
Private consumption	-7.5	12.2	15.1	2.3	1.3	2.8	1.0
Goods and services exports	-1.0	3.5	1.1	4.3	5.4	3.7	4.2
Goods and services imports	-12.7	21.4	23.2	3.6	2.7	2.9	2.5
Current account (% of GDP)	1.4	-0.9	-0.8	-1.6	-1.1	-2.4	-1.9

Source: Central Bank of Chile.

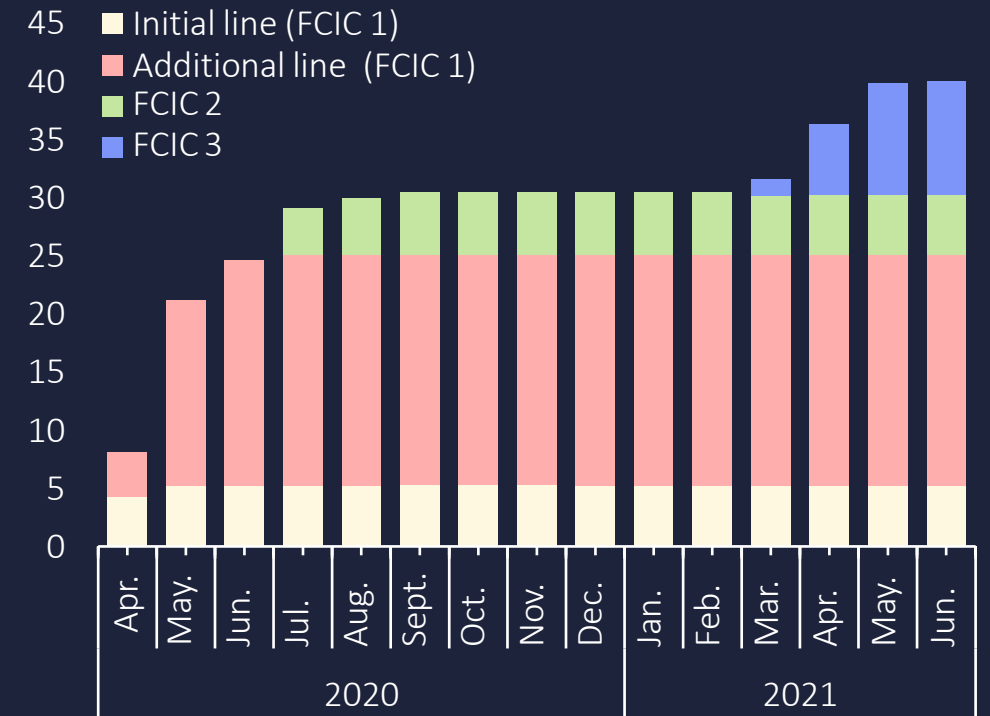
Regarding credit to firms, use of Fogape-Reactiva has remained strong. At the same time, FCIC 3 has been totally used up.



Fogape-Reactiva by firm size
(thousand operations)



Use of the Credito Facility Conditional on Increased Lending (FCIC) (*)
(billions of dollars)

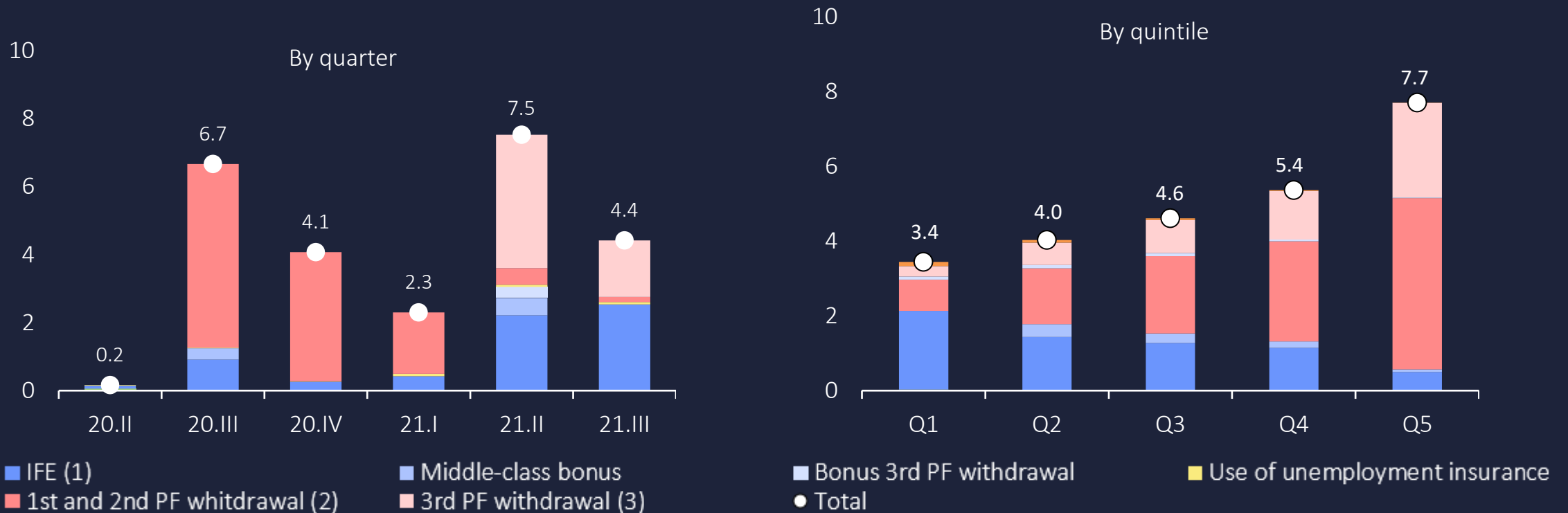


(*) Considers nominal exchange rate at \$720.
Sources: Central Bank of Chile and www.fogape.cl

Withdrawals of pension savings and massive fiscal transfers have been and will continue to be important factors behind the dynamism of private consumption.



Household liquidity support measures (2020.II to 2021.III)
(percentage of the GDP)



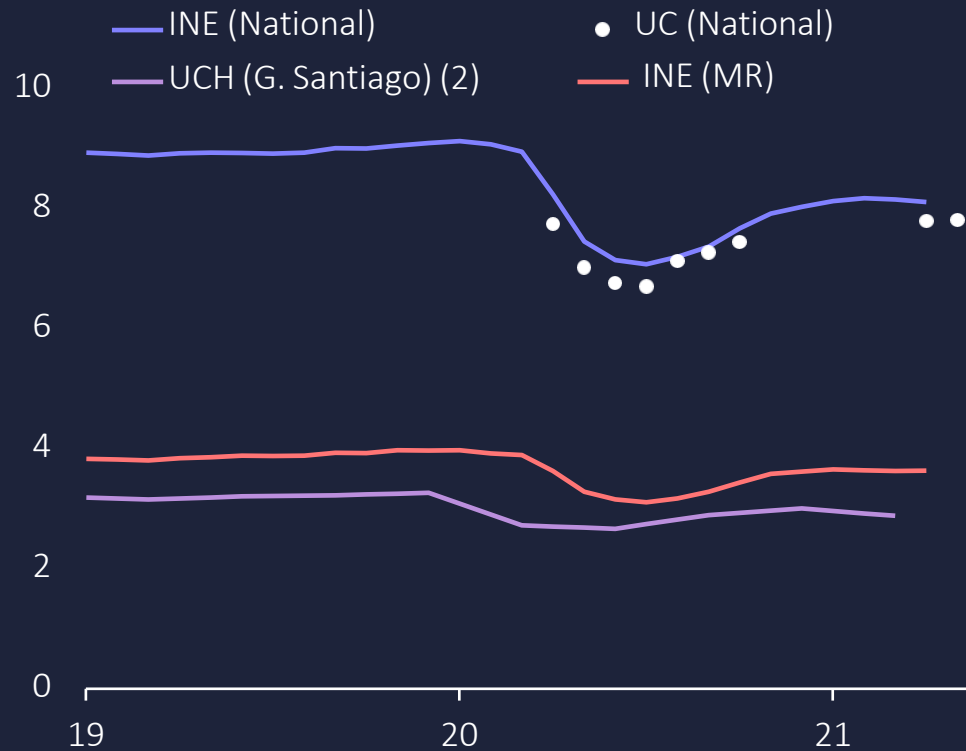
(1) IFE has grown in amounts and coverage, going from more than 6 mill. average beneficiaries between May-20 to Mar-21 until reaching more than 12 million in Apr-21. Likewise, amounts per capita have increased, going from \$US 70 in its beginnings to the most recent of \$US 140 per capita in the IFE of Apr-21. IFE for May-21 is an estimate based on a report from the Ministry of Social Development (05-12-2021). From Jun-21 to Sep-21, the Universal IFE proposal is considered approved, which corresponds to the total payments divided by 4 months, estimate based on financial report No. 79, DIPRES (06-02-2021). Assumed nominal exchange rate at \$719. (2) 1st and 2nd PF withdrawals correspond to amounts paid based on statistical records of the Superintendency of Pensions as of 04-30-2021. For the 21.III, the difference between the estimated total amounts to be withdrawn and the amount paid up to 04-30-2021 is considered. (3) 3rd PF withdrawal: 21.II corresponds to amounts paid based on the statistical file of the Superintendency of Pensions as of 05-28-2021 and 21.III corresponds to the difference between the total estimated amount to be withdrawn and what was paid up to on 05-28-2021. Sources: Central Bank of Chile, Ministry of Finance and Superintendency of Pensions.

The labor market has improved from its worst levels of last year, albeit the recovery is still incomplete.

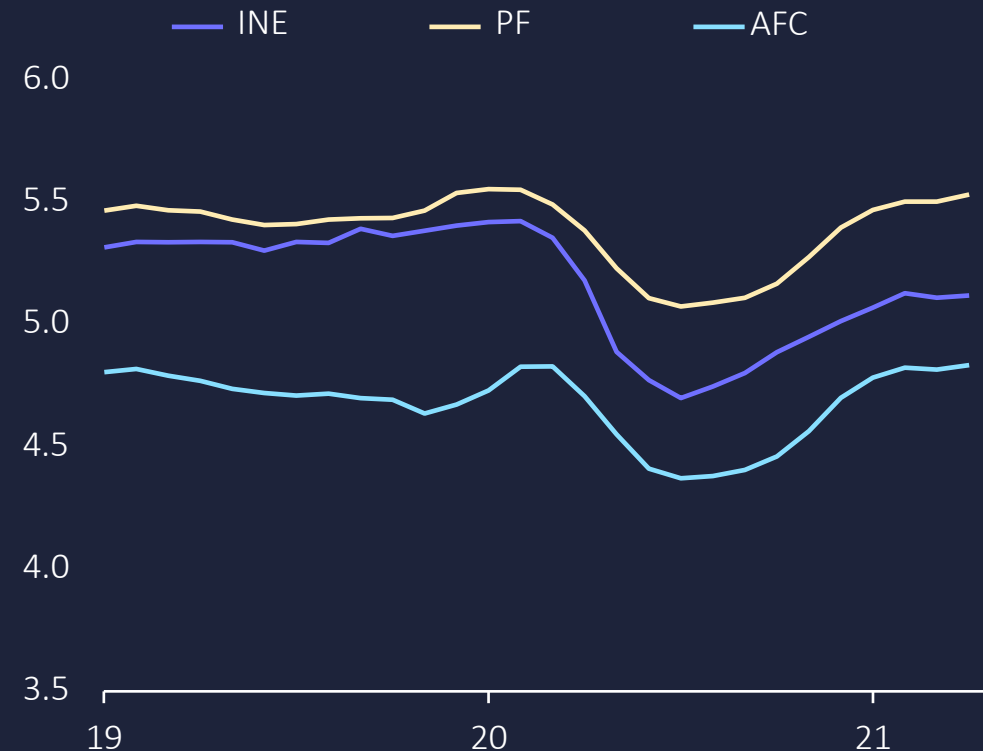


Employment indicators (1)
(millions of persons)

National, Met. Region and Gr. Santiago



Formal salaried(3)

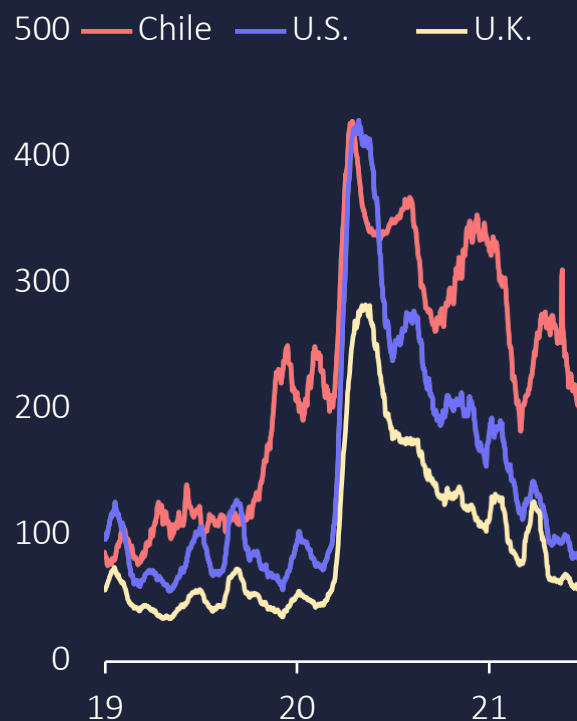


(1) INE, AFC (unemployment insurance), and PF (pension funds) data in moving quarterly averages. (2) Quarterly data with monthly interpolation. (3) INE stands for salaried formal employment; PF measures number of dependent contributors, salaried public workers, and household help whose employer made normal payments to the individual pension fund capitalization account; AFC refers to number of dependent contributors (salaried private workers) whose employer made normal payments to unemployment insurance. Sources: Catholic University Survey Center, INE, Superintendency of Pensions, and University of Chile.

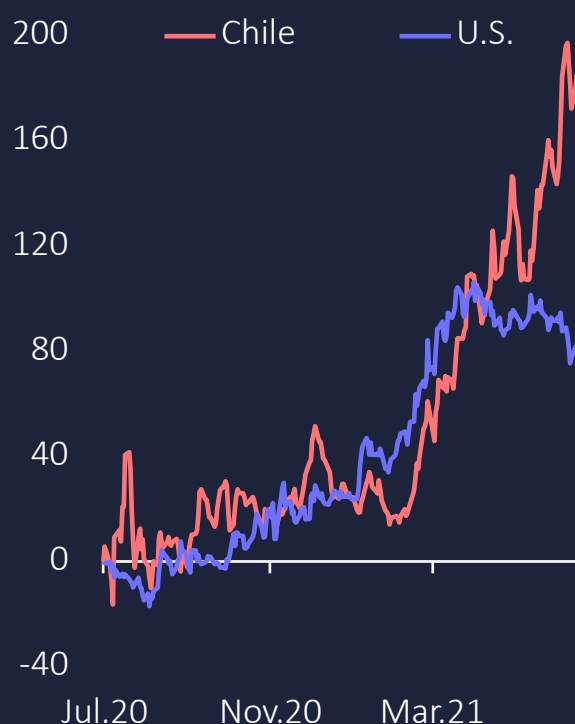
Even with the stronger economic dynamism, household expectations are still in pessimistic territory amid high uncertainty. This has coincided with local financial markets decoupling from global trends, despite significant copper price hike.



Perception and uncertainty –
EPU and DEPUC (1)
(index)



Nominal 10-yr benchmark
interest rates
(change with respect to 1 July 2020, basis points)



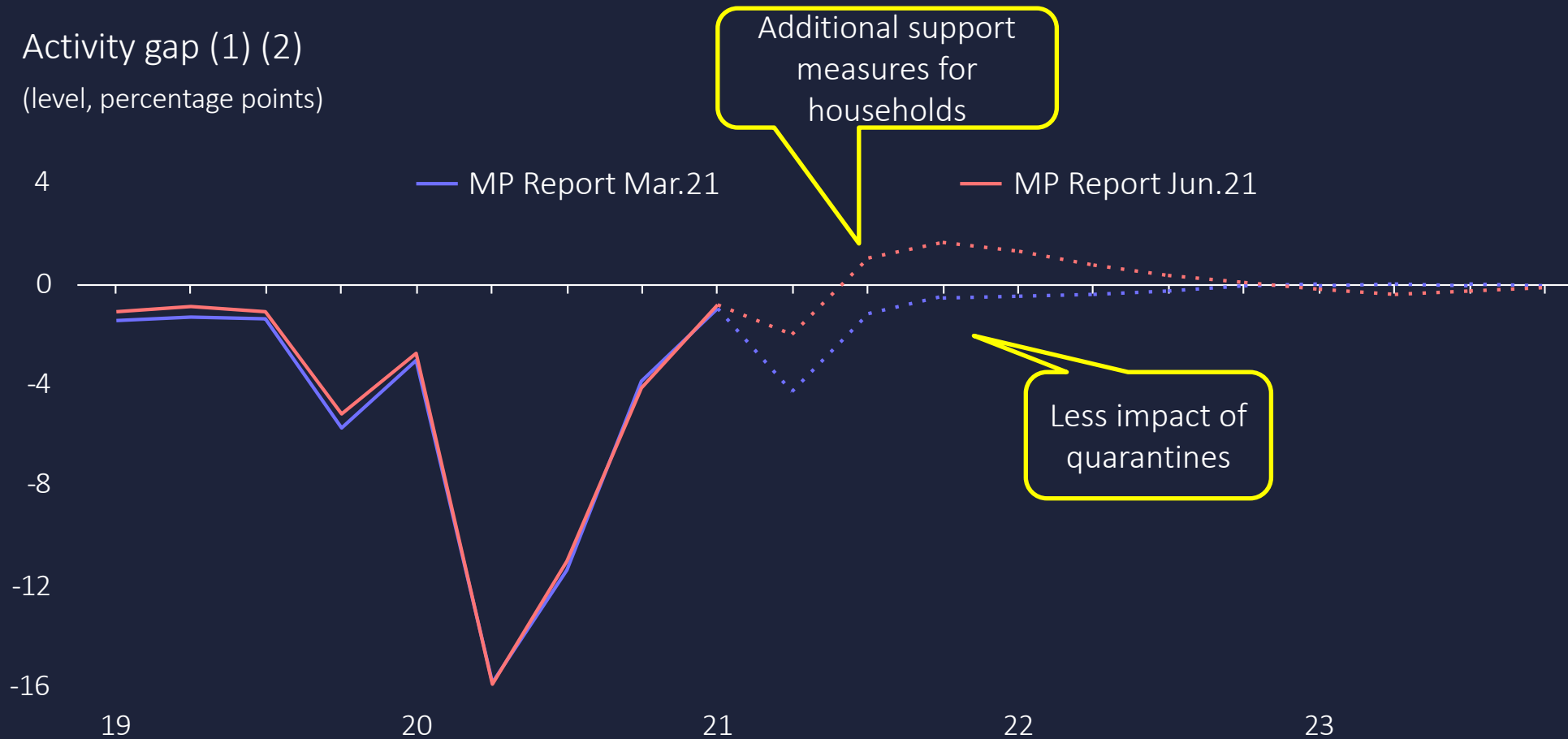
Stock markets (2)
(change with respect to 1 July 2020, percent)



(1) Moving 30-day average. (2) World stands for the stock market index ACWI in local currency of Morgan Stanley Capital International. For Chile, the IPSA is used.

Sources: Becerra and Sagner (2020), Bloomberg, Central Bank of Chile and www.policyuncertainty.com.

The greater impulse to expenditure combined with recent better performance of the economy translates into a faster closing of activity gap.



(1) Historical gap estimates are changed due to re-estimation of potential GDP. The Multivariate Filter was used in the projection, which incorporates the new trend growth of non-mining GDP (2021-2030 average: 2.9%). (2) Dotted lines indicate forecasts.

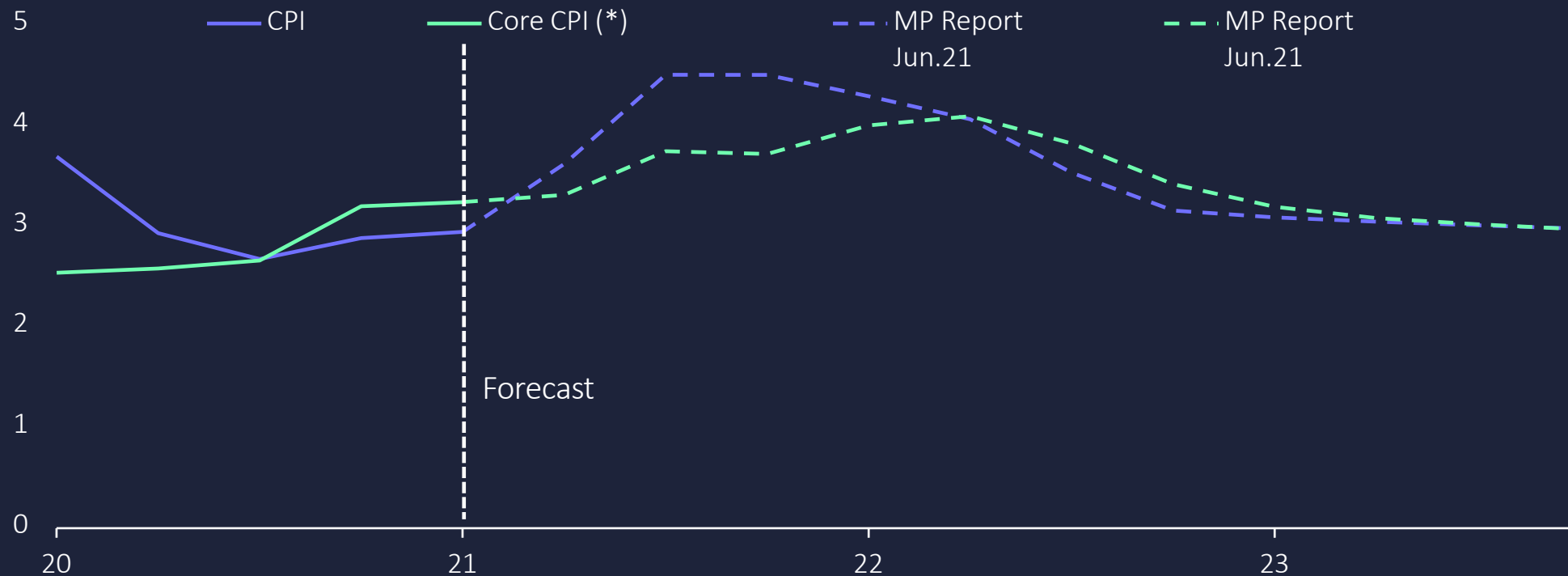
Source: Central Bank of Chile.

Inflation forecasts are revised up. Headline CPI inflation is expected to exceed 4% annually in the short term.



Inflation forecast

(annual change, percent)



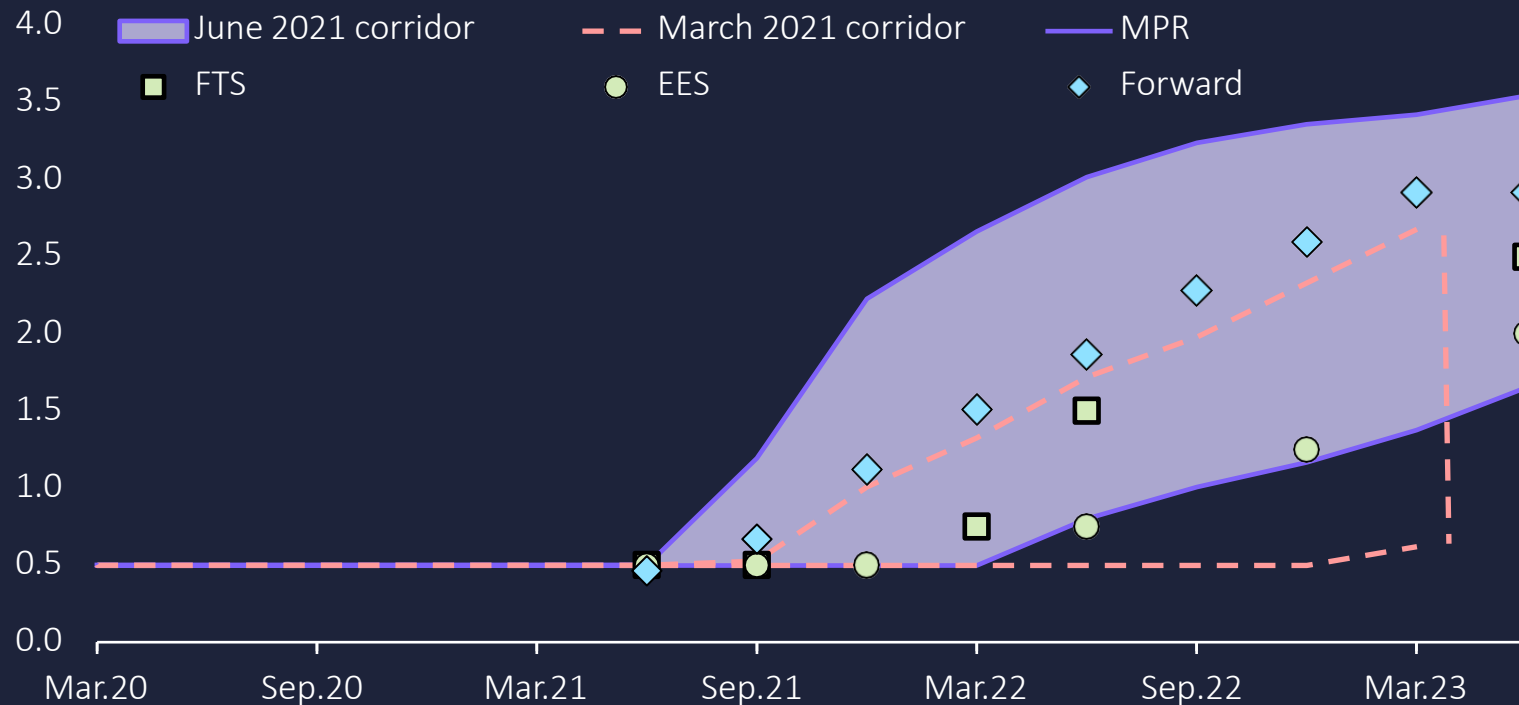
(*) Measured with CPI w/o volatiles.

Sources: Central Bank of Chile and INE.

The expected higher growth in expenditure and activity will make it less necessary for the monetary impulse to support the economy's recovery with the same intensity, so it should begin to moderate gradually, sooner than was anticipated in the last MP Report.



MPR corridor (*)
(percent)



(*) The corridor is constructed following the methodology in Box V.1 of the March 2020 MP Report. It includes the Financial Brokers Survey (FBS) published on June 3, the EES published on May 11 and the quarter's average smoothed forward curve. Methodology: extraction of the implicit MPR considers the forward curve over overnight swap curve for up to 2 years, discounting the fixed rates of each term from the simple accrual of the overnight index swap (OIS). Source: Central Bank of Chile.



Possible reasons:

Households more willing to consume
More persistent effects of global cost pressures



Possible reasons:

Slower openings due to less favorable evolution of pandemic
Sluggish investment due to high local uncertainty

Risks:

Evolution of public finances
Inflation and worsening of external financial conditions



The Chilean economy has outperformed expectations, reflecting the strong macroeconomic momentum, more favorable external conditions, and the agents' better adaptation to the sanitary constraints.

Even with these more positive prospects for recovery, the overall economic perception worsened in recent months, which could be due to the repeated outbreaks of infection, the application of new quarantines, the lag of some economic sectors and part of the labor market, and the greater uncertainty.

The better recent performance of the economy, the significant boost to domestic demand, the imbalances in the dynamics of expenditure and production, added to cost pressures, will affect the behavior of prices, which so far have behaved as expected.

In this scenario, the activity gap closes sooner, so the monetary impulse should begin to moderate sooner than was expected in the last MP Report, although it will remain high for an extended period. It is estimated that, in the central scenario, the MPR will be below its —downward revised— neutral level throughout the policy horizon, underpinning a recovery process that will continue to meet with significant challenges.

The crisis of the last nineteen months will pose major challenges to the Chilean economy. Importantly, there is the need to shape a sustainable trajectory for public finances, reduce economic uncertainty, and reverse the reduction in trend growth described in this Report.



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