MONETARY POLICY REPORT

MARCH 2022

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banco central Chile

The Central Bank of Chile's monetary policy conduct

Money plays a fundamental role in the proper functioning of any economy. To preserve it, monetary policy must protect the value of the national currency —the peso— aiming at ensuring low, stable inflation. Achieving this objective promotes the well-being of individuals, as it looks after the purchasing power of their income and contribute to the good performance of the economy. When succeeding in having inflation low and stable, monetary policy can also smooth the fluctuations of employment and output.

The Central Bank of Chile conducts monetary policy with the aim that, irrespective of the current level of inflation, its projection over the two-year horizon stands at 3% annually. This resembles what is done in other countries that, like Chile, have a floating exchange rate, and this is what is known as the inflation-targeting scheme.

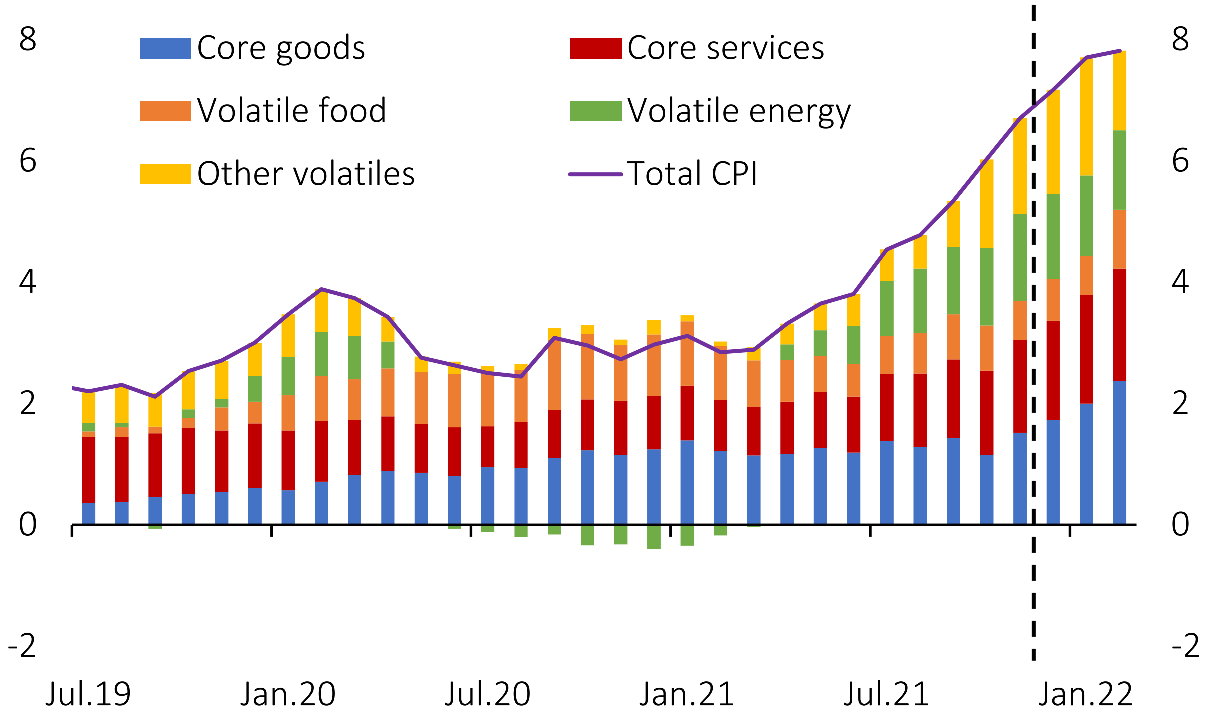
The monetary policy interest rate (MPR) is the main instrument used by the Bank to achieve the inflation target. Its level es determined at the Board's monetary policy meeting, which takes place eight times a year. In practice, the MPR is a benchmark interest rate to determine the cost of money and other financial process, such as the exchange rate and longer-term interest rates. In turn, these variables affect demand for goods and services and therefore prices and inflation. Monetary policy decisions take several quarters to be fully reflected in the economy, which explains why monetary policy takes a forward-looking standpoint, having as its main focus inflation expectations two years out and not only today's inflation.

Because the Central Bank makes its monetary policy decisions autonomously, it must constantly account for them and their results to the general public. This owes not only to the fact that it is a state-run agency in a democratic society, but also because a credible monetary policy that is understood by the people allows keeping inflation low and stable. Through its Monetary Policy Report, the Bank communicates to the general public its vision on the recent evolution of the economy, its projections for the coming years and the way in which, in such context, it will handle monetary policy to achieve the inflation-targeting objective

Inflation continues to rise and is approaching 8% annually, with increases in most of its components.

Inflation indicators (1) (2)

(contributions to anual change, percentage points)



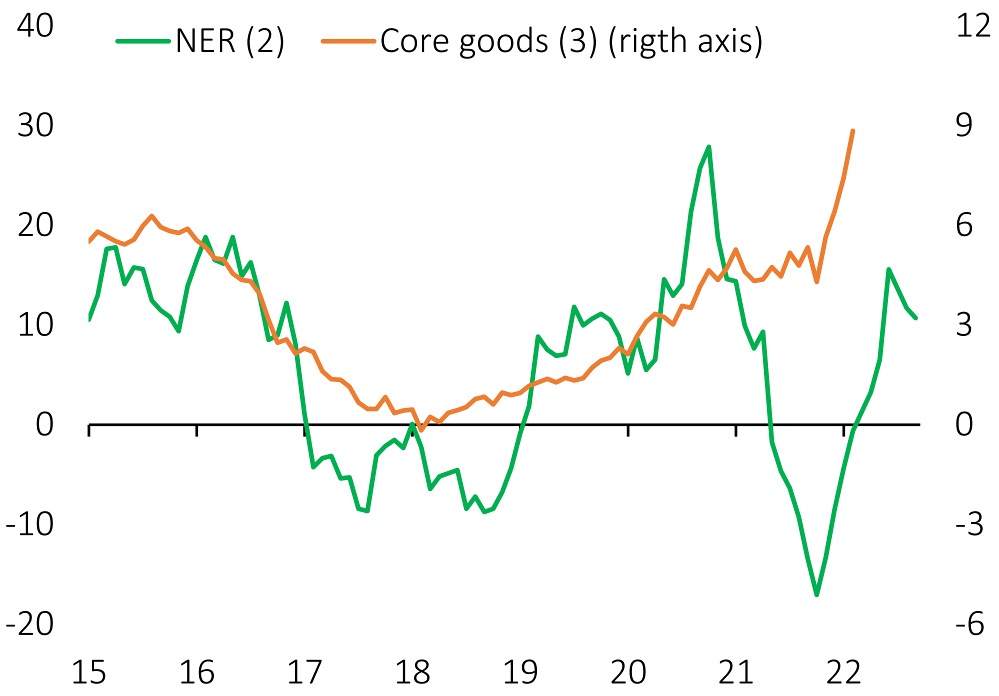
Core goods	8.8%
Core services	4.9%
Volatile food	8.9%
Volatile energy	17.8%
Other volatiles	7.7%
Total CPI	7.8%

(1) Dashed vertical line indicates statistical cutoff of December 2021 Monetary Policy Report. (2) For further detail of the different groupings and their share in the headline CPI basket, see box IV.1 in December 2019 MP Report, Carlomagno & Sansone (2019), and economic glossary. Sources: Central Bank of Chile and National Statistics Institute (INE).

Core CPI reflects mainly the fast increase in goods inflation, while services inflation has been conteined by lags in the inflation-correction of some ítems.

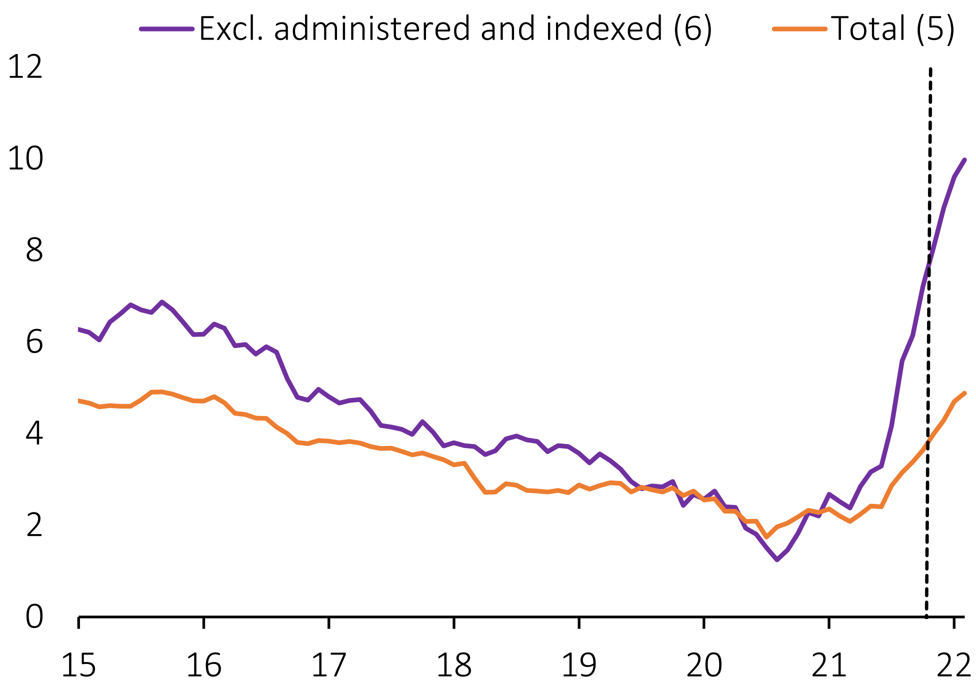
Core goods inflation and exchange rate (1)

(annual change, percent)



Core services inflation (1) (4)

(annual change, percent)

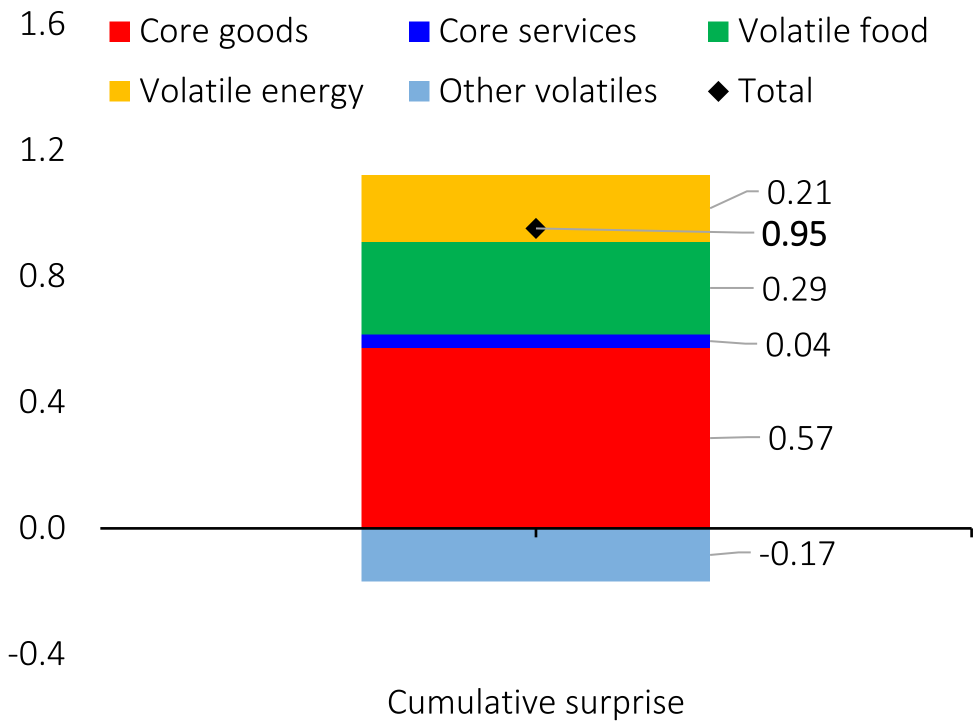


(1) For further detail of the different groupings and their share in the headline CPI basket, see box IV.1 in December 2019 MP Report, Carlomagno & Sansone (2019), and economic glossary. (2) Lagged 6 months. March 2022 figure considers information up to the 23rd. (3) Represents 26.7% of CPI basket. (4) Dashed vertical line indicates statistical cutoff of December 2021 Monetary Policy Report. (5) Represents 38.4% of CPI basket. (6) Represents 11.7% of CPI basket. Sources: Central Bank of Chile and National Statistics Institute (INE).

Inflation has risen past December forecasts. In a context in wich the strong boost to spending in 2021 has added greater cost pressures.

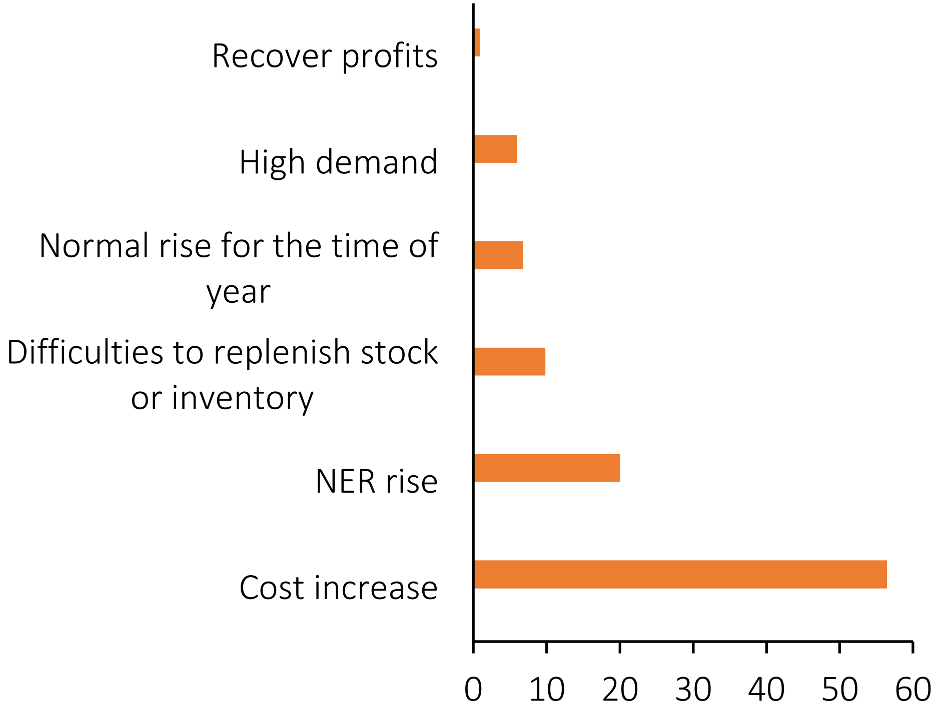
Cumulative inflation surprises after December 2021 MP Report (*)

(annual change, percent)



February IPN: Main reason why you raised prices in last three months

(percent of all firms that did raise prices)

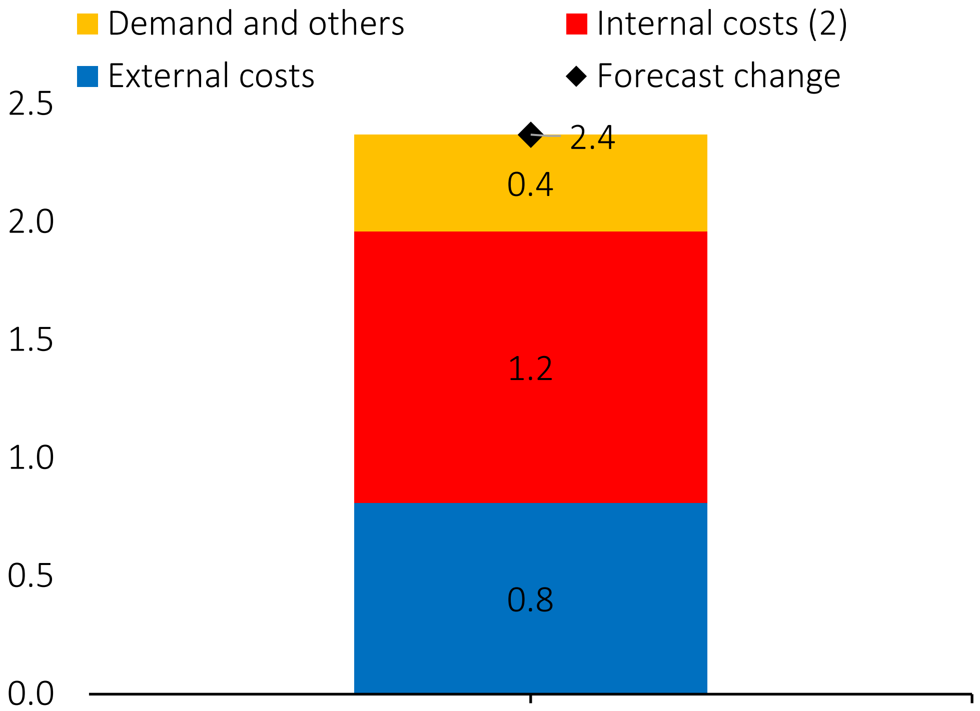


(*) For further detail of the different groupings and their share in the headline CPI basket, see box IV.1 in December 2019 MP Report, Carlomagno & Sansone (2019), and economic glossary. Source: Central Bank of Chile.

Accordingly, the short-term outlook for annual inflation has been revised upward, and it is foreseen to approach 10% by mid year.

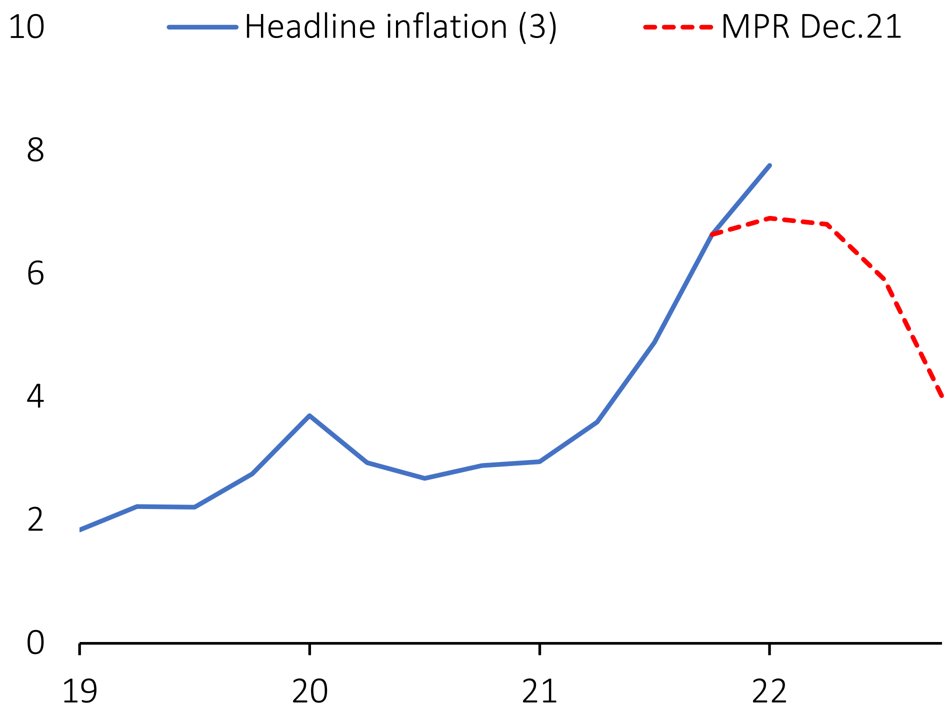
Change in annual inflation forecast at 4Q2022 (1)

(percentage points)



Headline inflation and December forecast

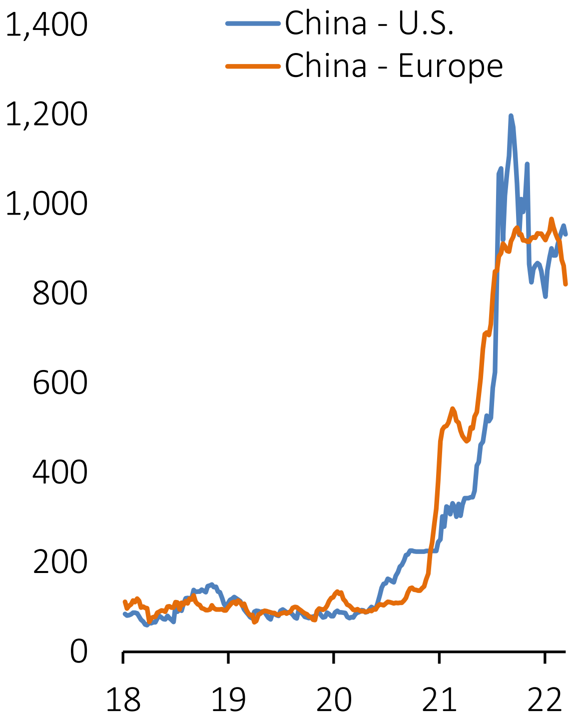
(annual change, percent)



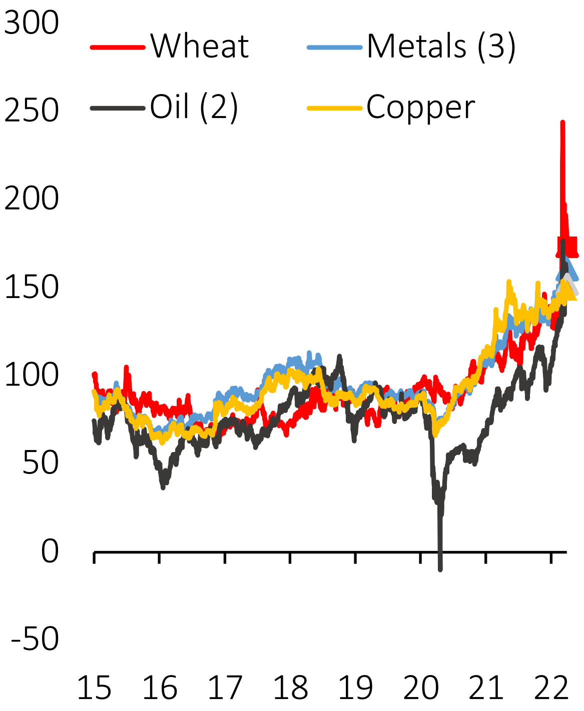
(1) Considers headline CPI inflation forecast in MP reports of December 2021 and March 2022. (2) Includes effect of exchange rate variation. (3) Corresponds to averaged annual CPI variation in January-February 2022.
Source: Central Bank of Chile.

Increased cost-push pressures occur in a context where supply chains are still under stress, commodity prices are higher, and the Chilean peso is still depreciated.

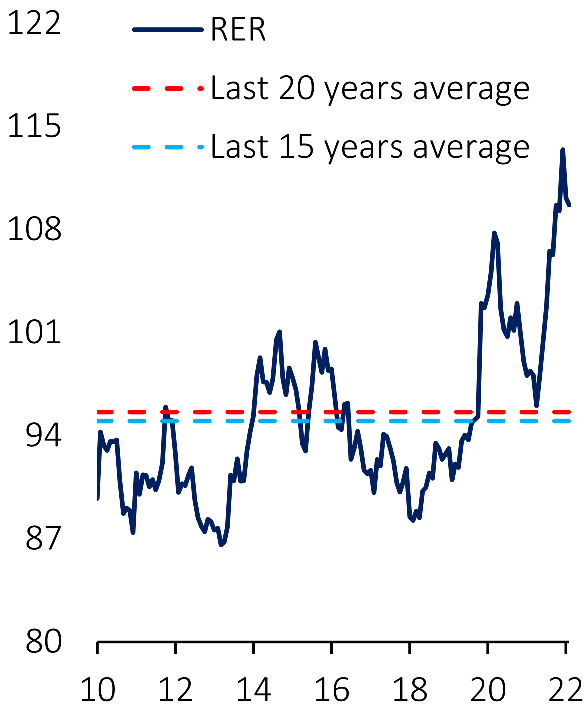
Maritime freight costs (1)
(index, 2018=100)



Commodity prices
(index, 2010-2022 average = 100)



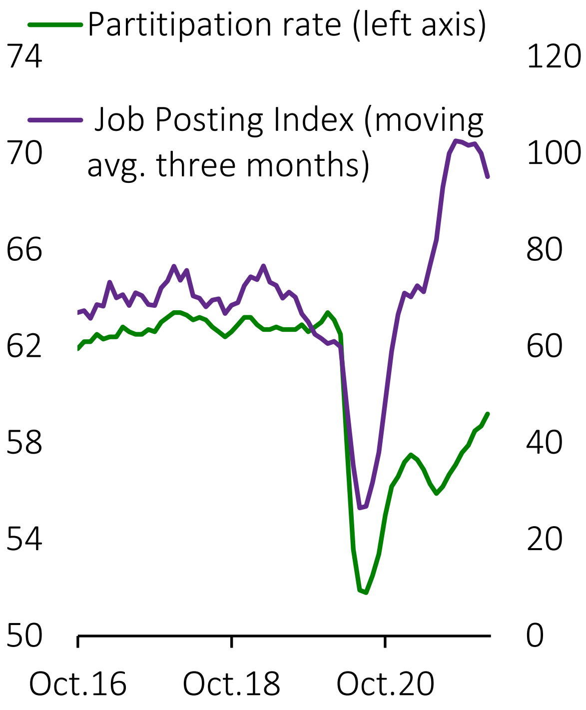
Real exchange rate(4)
(index, 1986 average = 100)



(1) Cost of transporting a 40-foot container in respective routes. (2) WTI-Brent average barrel. (3) S&P GSCI Industrial Metals. (4) Averages of last 15 and 20 years cover the periods Mar.07-Feb.22 and Mar.02-Feb.22, respectively.
Sources: Bloomberg and Central Bank of Chile.

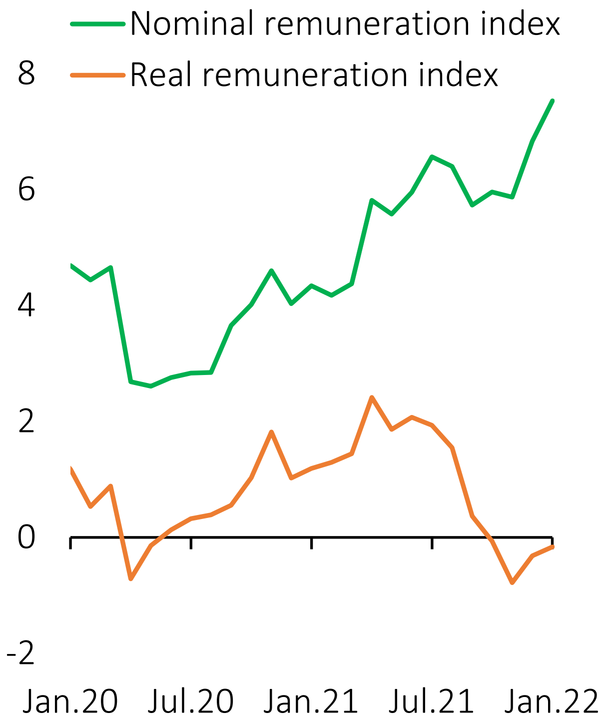
Regarding labor costs, the supply-demand mismatch has been subsiding, but continues to put upward pressure on wages.

Participation rate and index of job postings on internet
(percent; index, Jan.2015 = 100)



IPN February: measures to address difficulty to recruit workers
(percent of all firms)

Compensation index (IREM)
(percent)

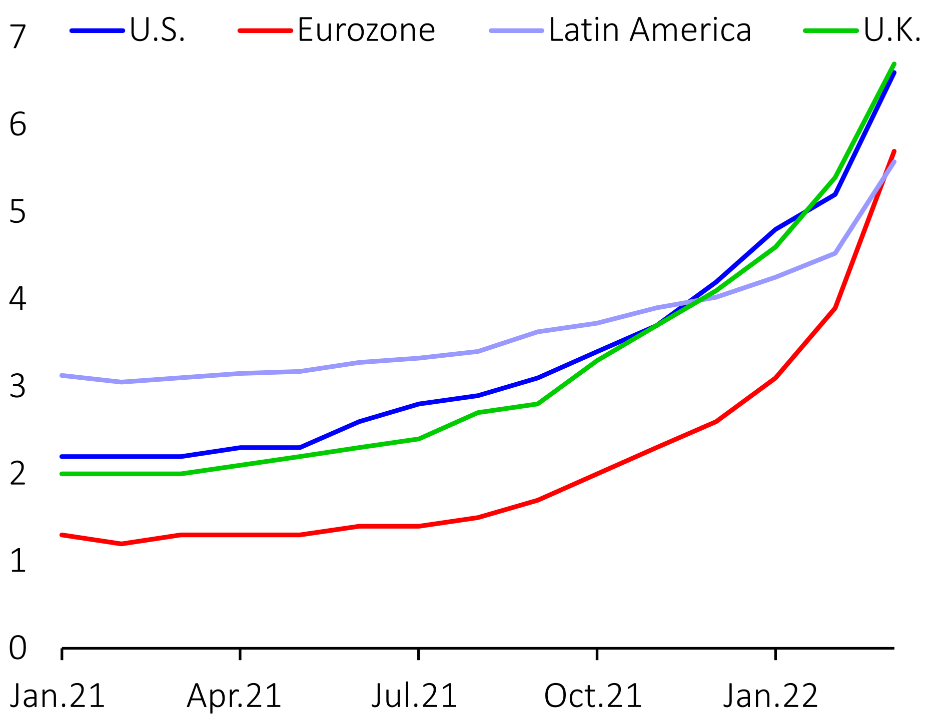


(*) Includes job postings in media, web portals, and social networks, among others.
Sources: Central Bank of Chile and National Statistics Institute (INE).

Rising inflation has become a global phenomenon, but underlying causes differ across countries.

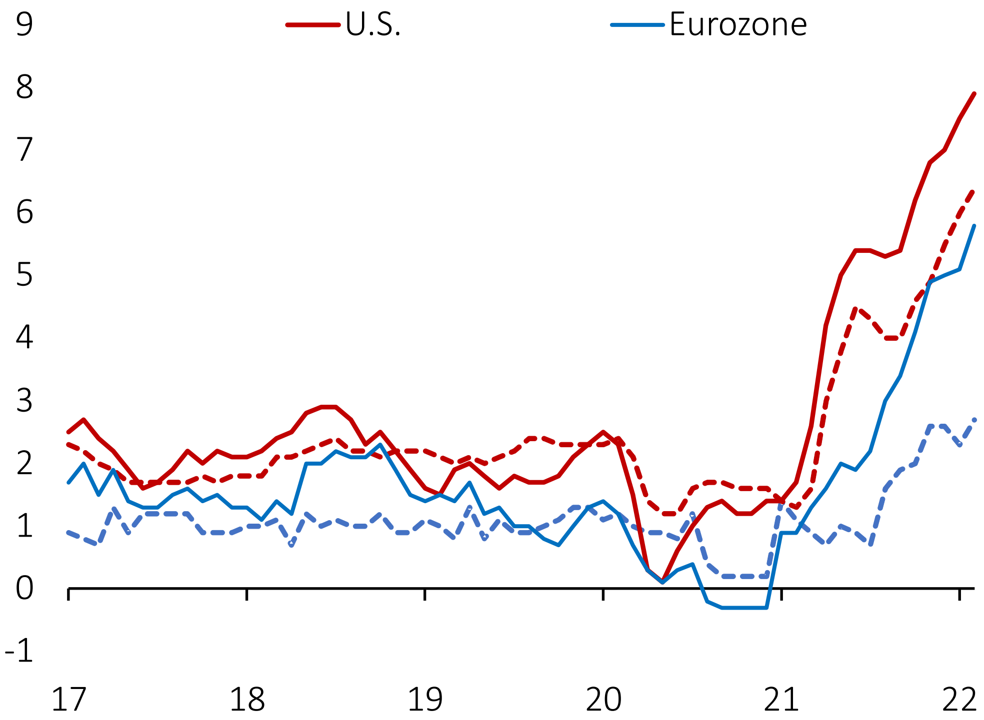
Inflation forecast for 2022 (1)

(average annual change, percent)



Headline and core inflation in developed economies (2)

(annual change, percent)



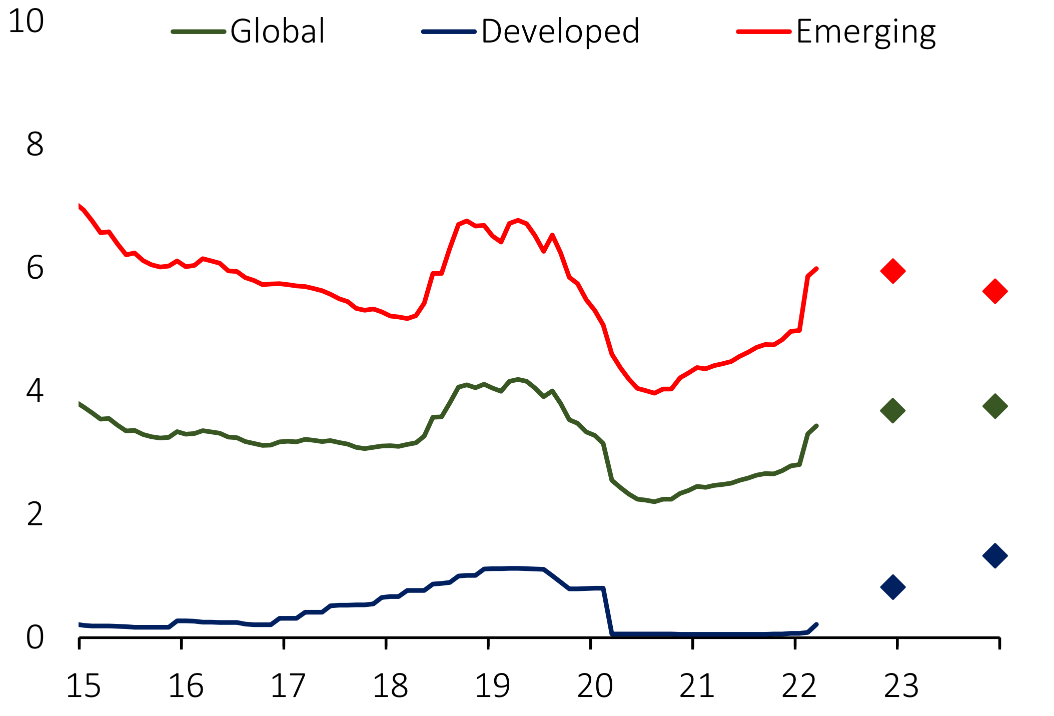
(1) Latin America considers simple average of annual inflation at December 2022 for Brazil, Mexico, Peru, and Colombia. (2) Dashed lines show respective core inflation.

Sources: Central Bank of Chile, Bloomberg, and respective countries' statistical bureaus.

This has led central banks to tighten monetary policy as global financial conditions are expected to be less favorable.

Global policy rates and expectations

(percentage points, PPP weighted)



Evolution of monetary policy rate in selected economies (1)

(basis points)

	Var. acumulada desde ene.21	Var. esperada al 4T22
Brazil	975	125
Chile	650	50
Hungary	380	75
Peru	375	125
Poland	340	175
Colombia	225	325
Mexico	225	125
New Zealand	75	100
Norway	75	75
South Africa	75	75
Korea	75	50
U.K	65	50
U.S.	25	100
Canada	25	100

Chile's MPR rise has been among the highest in the world.

+650bp

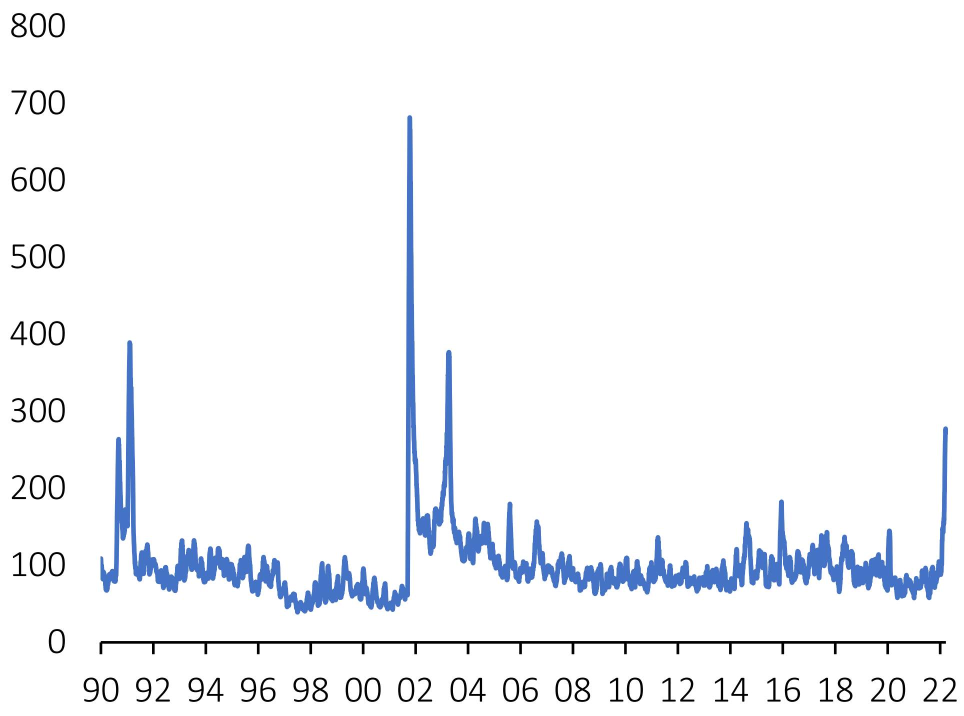
Since July 2021

(1) Expected MPR change is rounded off to nearest 25-bp increments. Expectations in Chile consider the March EES.
Sources: Central Bank of Chile and Bloomberg.

The Ukranian invasion has added an adverse effect to the macroeconomic scenario, together with increased uncertainty.

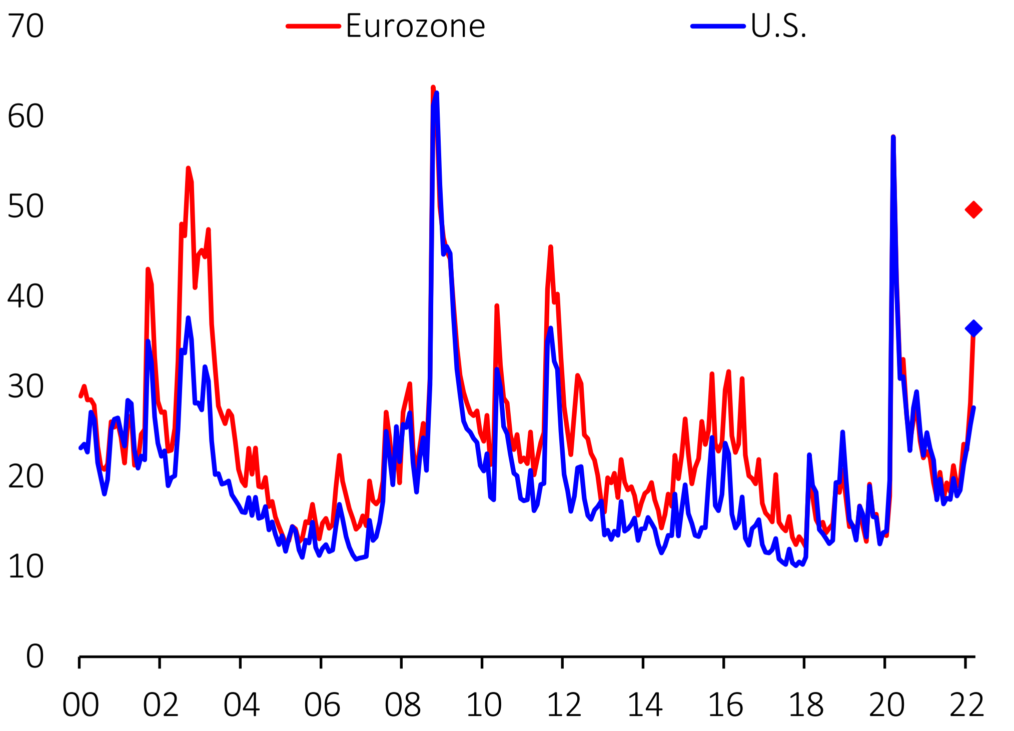
Geo-political risk (1)

(index, 1985-2019 average =100)



Financial volatility (2)

(index)

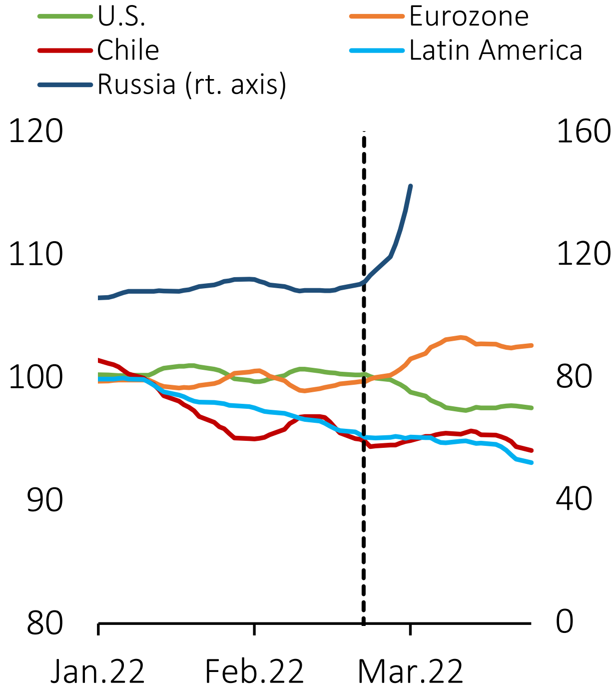


(1) Moving 30-day average. (2) Figures for the U.S. use VIX index; for the Eurozone, VIX STOXX index. Diamonds show maximum daily value reached during March 2022 (March 7 and 3, respectively).

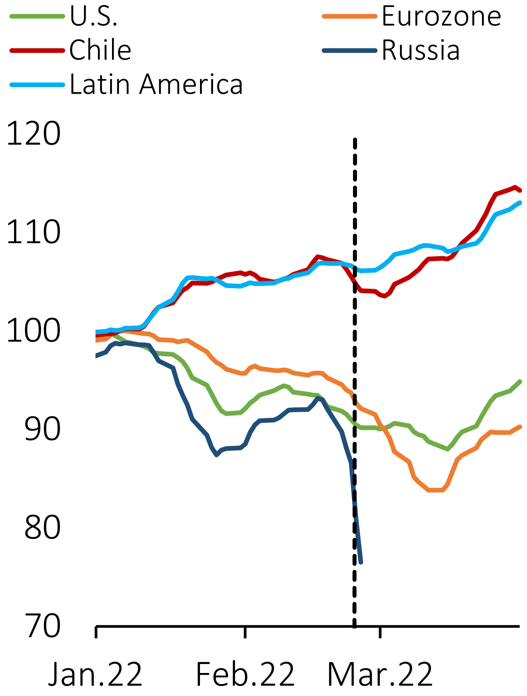
Sources: Bloomberg and Caldara & Iacoviello (2021).

But so far the financial consequences of the war have concentrated in Russia, Ukraine, and neighboring countries.

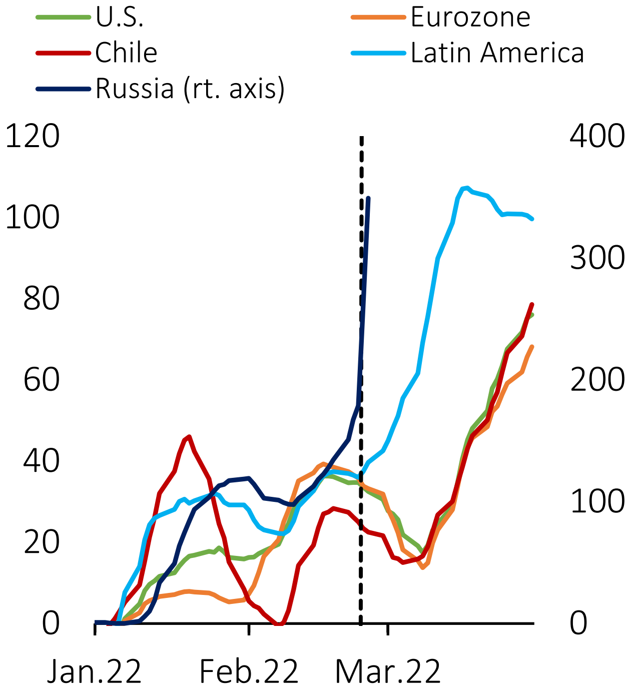
Currencies (1) (2) (3)
(index, 3/Jan/2022=100)



Stock markets (1) (2) (3)
(index, 3/Jan/2022=100)



10-year nominal interest rates (1) (2) (3)
(difference with respect to 3/Jan/2022=100, basis points)

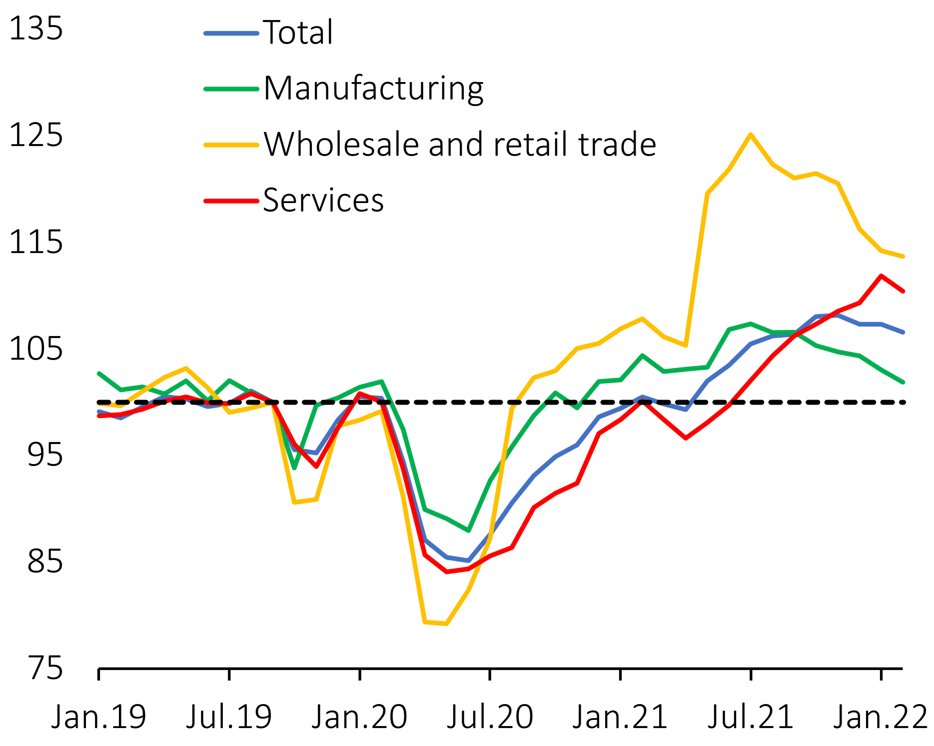


(1) Moving 7-day average for each index. (2) LatAm considers simple average of indexes of Brazil, Mexico, Peru, and Colombia. (3) For Russia the latest available data is considered (4/March for NER and 25/February for the stock market and 10-year nominal interest rate). Dashed vertical line shows start of Russian invasión to Ukraine (24 February).
Sources: Central Bank of Chile and Bloomberg.

In Chile, data for the end of 2021 suggest that the economy has already begun a process of scaling down the high levels of accumulated spending.

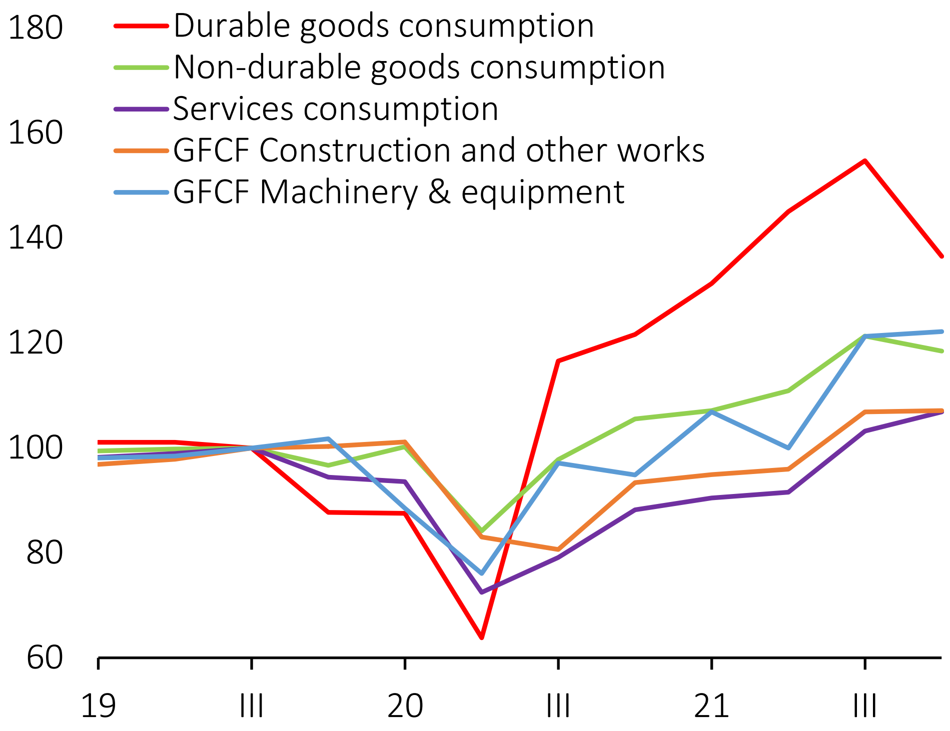
Monthly index of economic activity (Imacec)

(index, September 2019 = 100, deseasonalized series)



Domestic demand

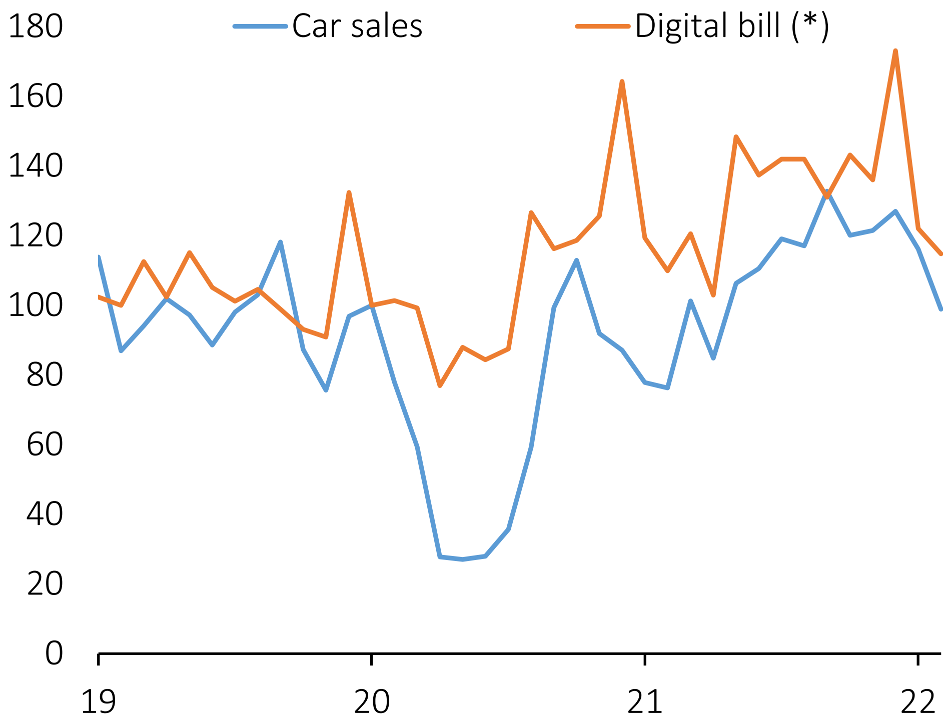
(index, third quarter 2019 = 100, deseasonalized series)



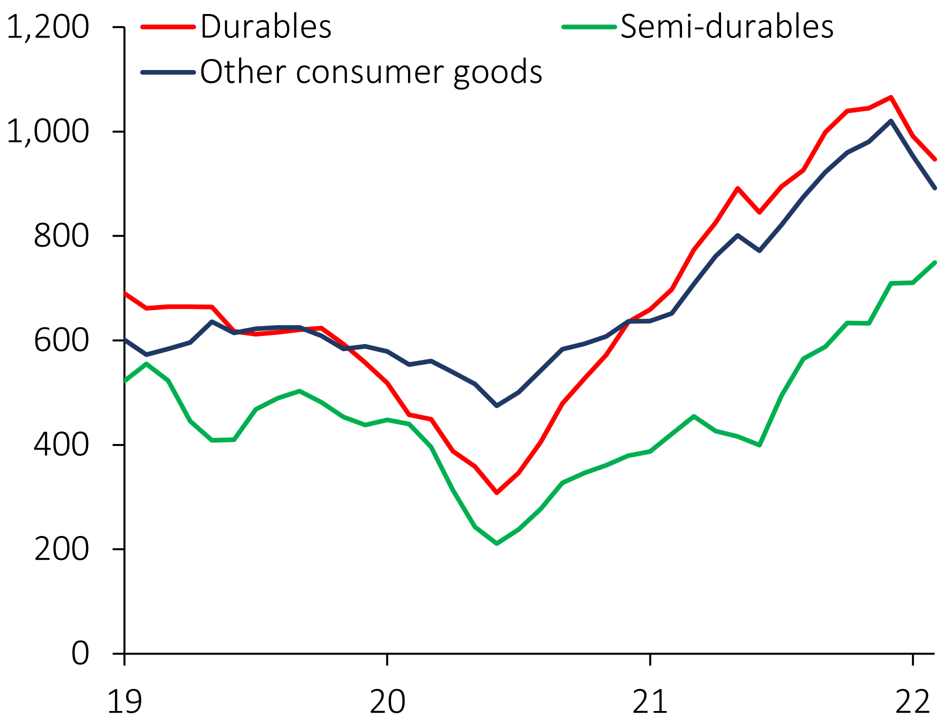
Source: Central Bank of Chile.

Several indicators confirm this trend running this year to date.

Trade indicators
(index, January 2020 = 100)



Nominal imports of consumer goods
(million CIF dollars, 3-month moving average)

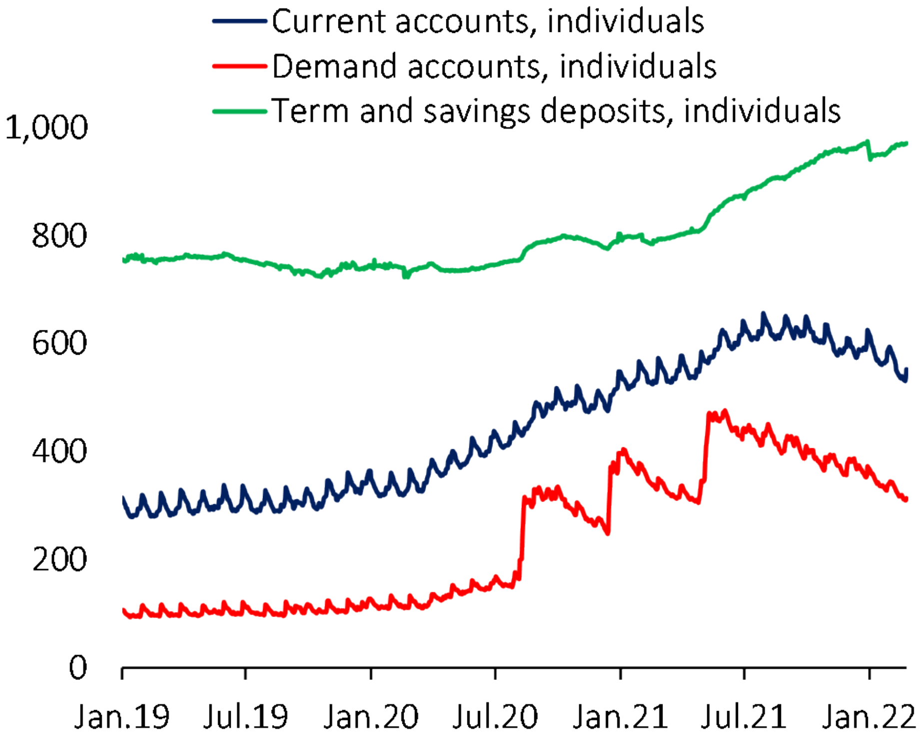


(*) UF-deflated. Excludes gas stations.
Sources: ANAC, Central Bank of Chile, INE, and tax authority (SII).

This is occurring amid dwindling liquidity in the economy, tighter financing conditions, and limited credit performance.

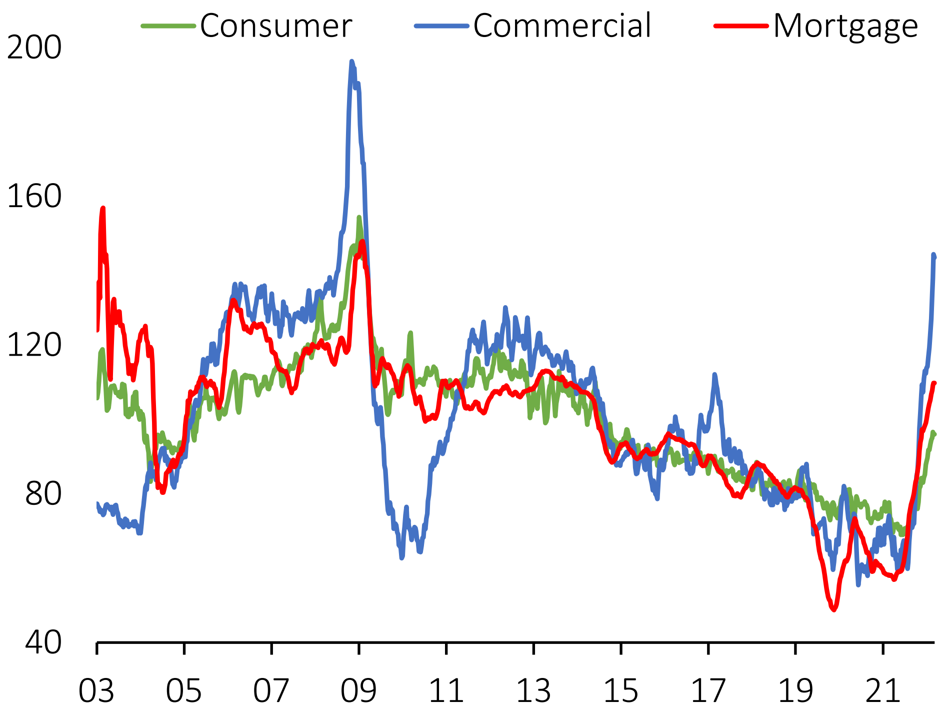
Individuals' real balances (1)

(millions of UFs, daily data)



Lending interest rates (2) (3)

(index, 2003-2022=100)

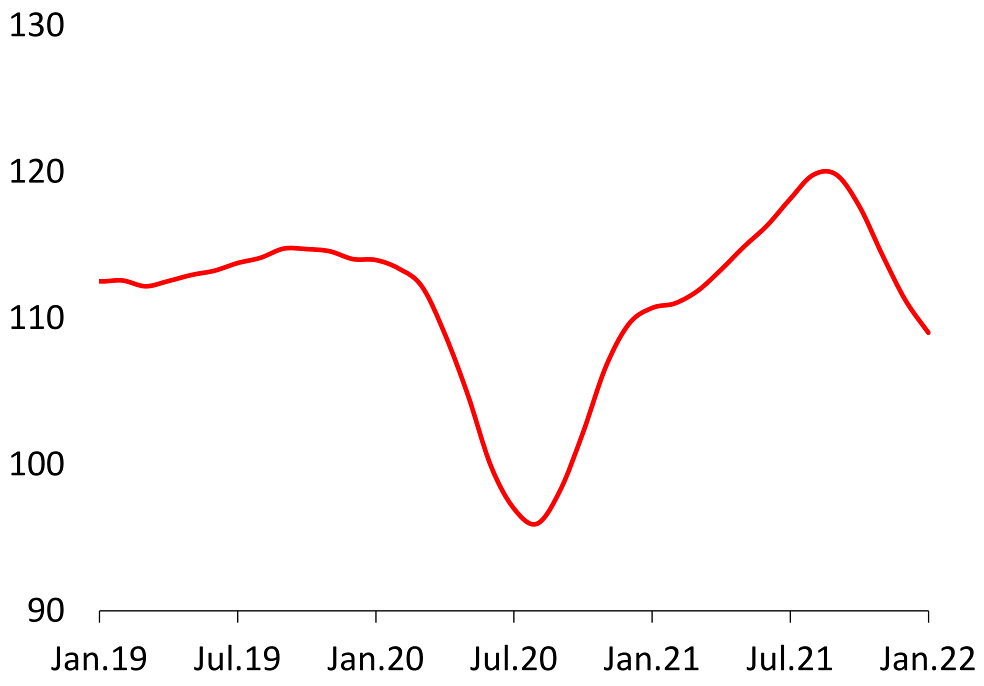


(1) In January 2022, the Compendium of Bank Accounting Standards of the Financial Market Commission was updated, which is used in the generation of monetary statistics. This change implied adapting the monetary compilation instruments of the Central Bank of Chile (from file F01 to SIM01).(2) Weekly data for the Metropolitan Region, weighted average rates of all transactions carried out in each period. For housing corresponds to transactions in UF. (3) Moving 4-week average. Source: Central Bank of Chile based on Financial Market Commission data.

Investment indicators show a reversal with respect of 2021, particularly in the construction and other works component.

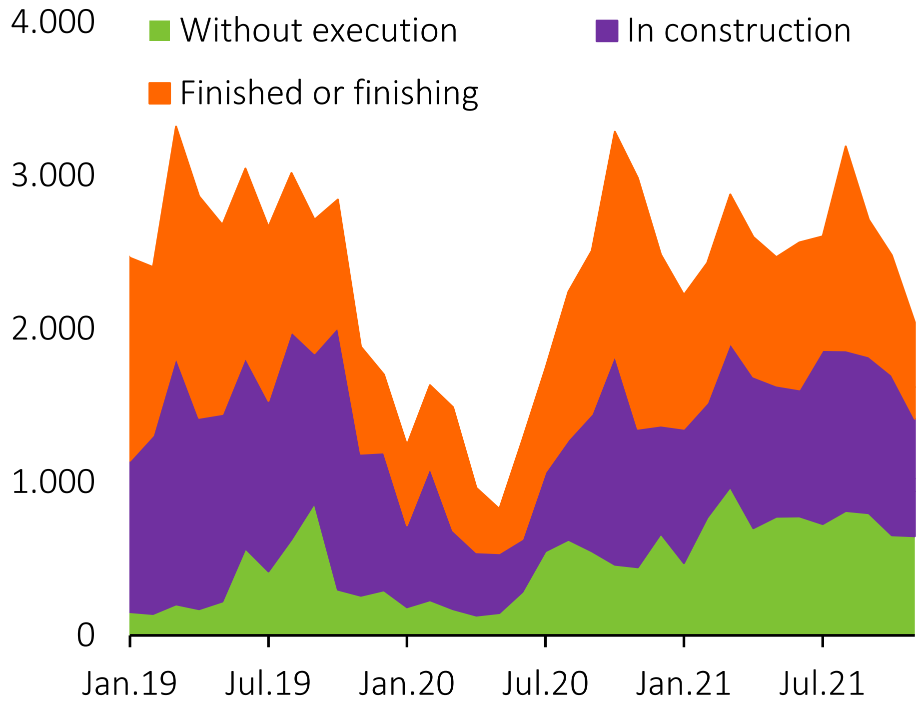
Monthly index of construction activity (Imacon) (*)

(index, 2014 = 100)



Home sales by status of works

(thousands of units)

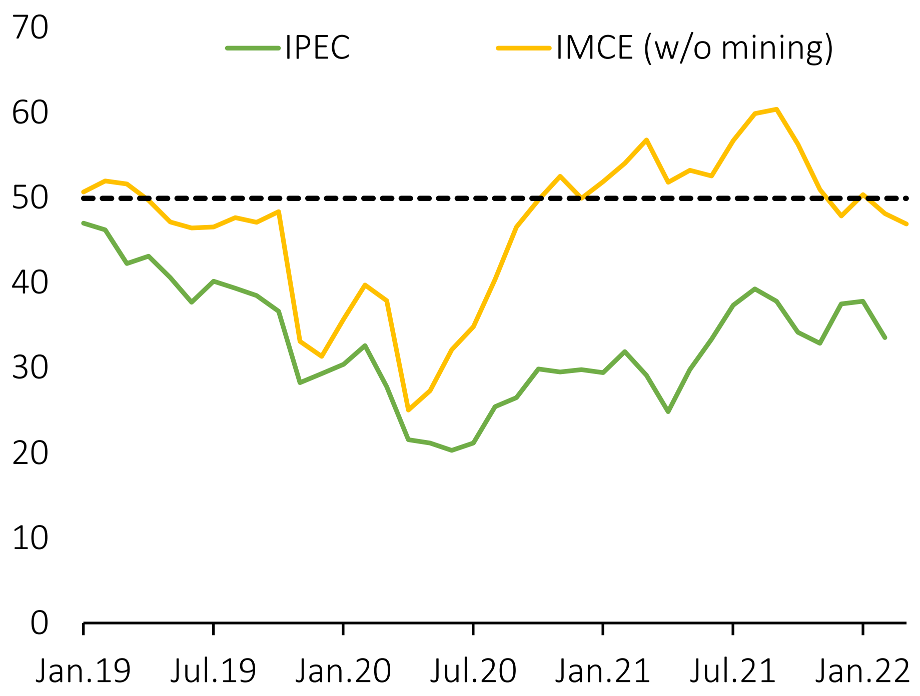


(*) Moving 3-month average.
Source: Chilean Chamber of Construction (CChC).

In this scenario, the outlook for businesses and consumers has turned more pessimistic, while uncertainty has increased further because of the war.

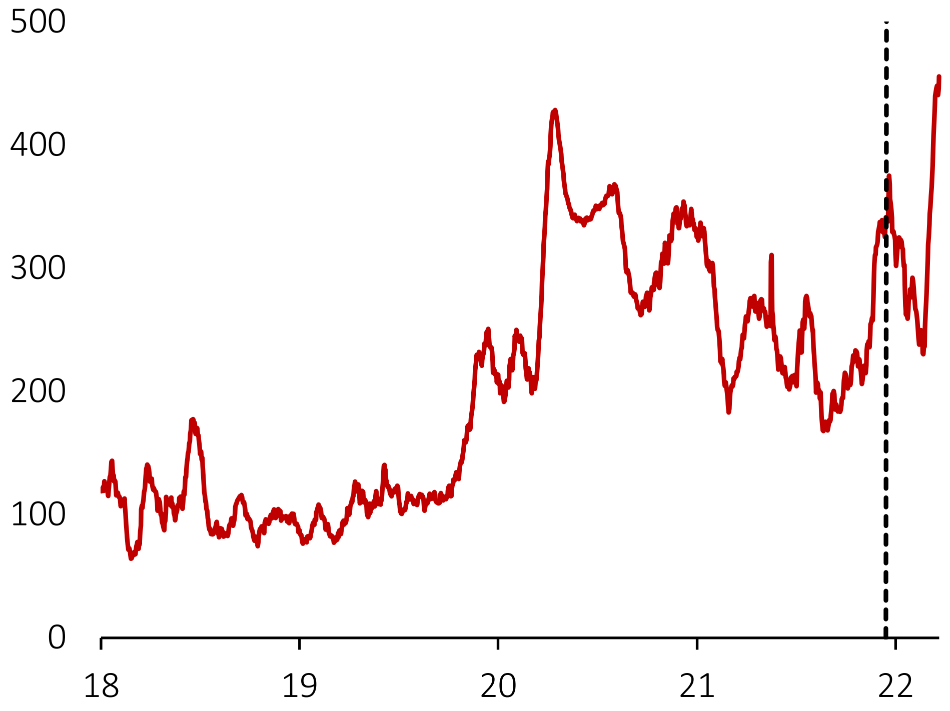
Business and consumer confidence (1)

(diffusion index)



Daily index of economic and political uncertainty (Depuc) (2)

(index, 1 January 2012=100)



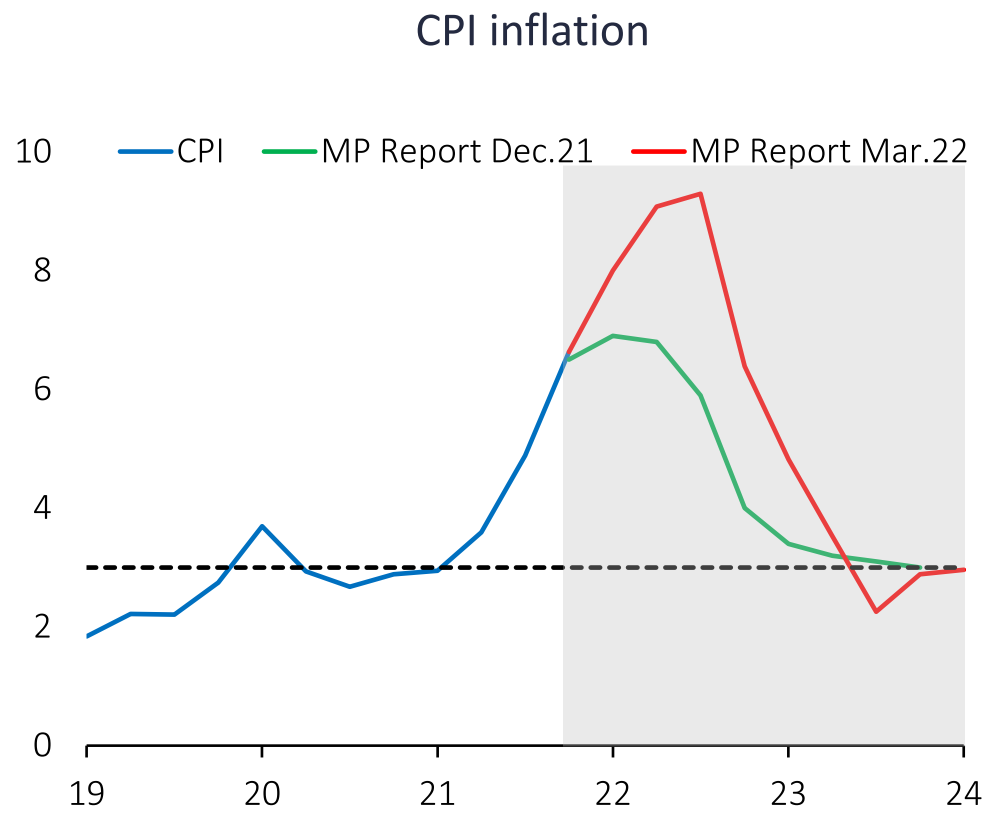
(1) Value above (below) 50 indicates optimism (pessimism) (2) Moving 30-day average. Since December 2021, the Depuc includes an update to the dictionary of words used for its construction and detailed in DTBC No. 883. This is done as a way of incorporating new elements that influence the local situation. From this date forward, the data dictionary will be subject to periodic updates based on the content of the corresponding news items. Dotted vertical line indicates date of publication of the December 2021 MP Report. Sources: Gfk/Adimark, UAI/ICARE, and Becerra & Sagner (2020).

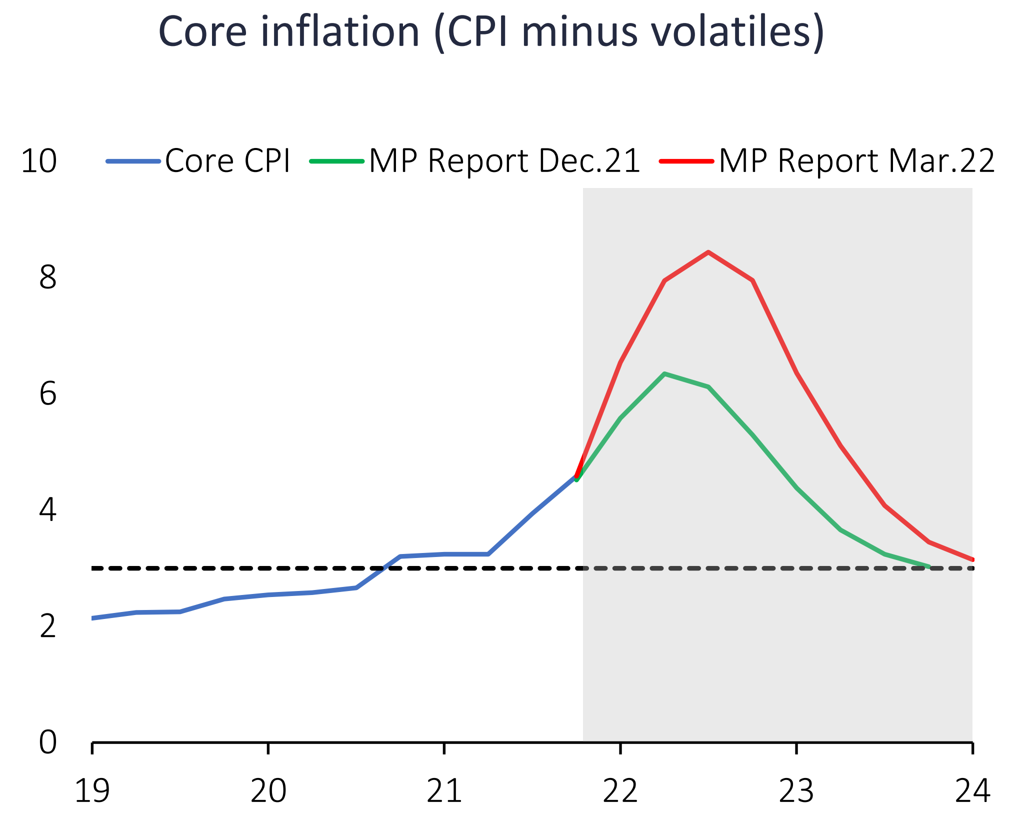
Projections

In the central scenario, inflation will approach 10% in mid-year, to begin a rapid decline towards the target in the latter part of 2022.

Inflation forecast (*)

(annual change, percent)



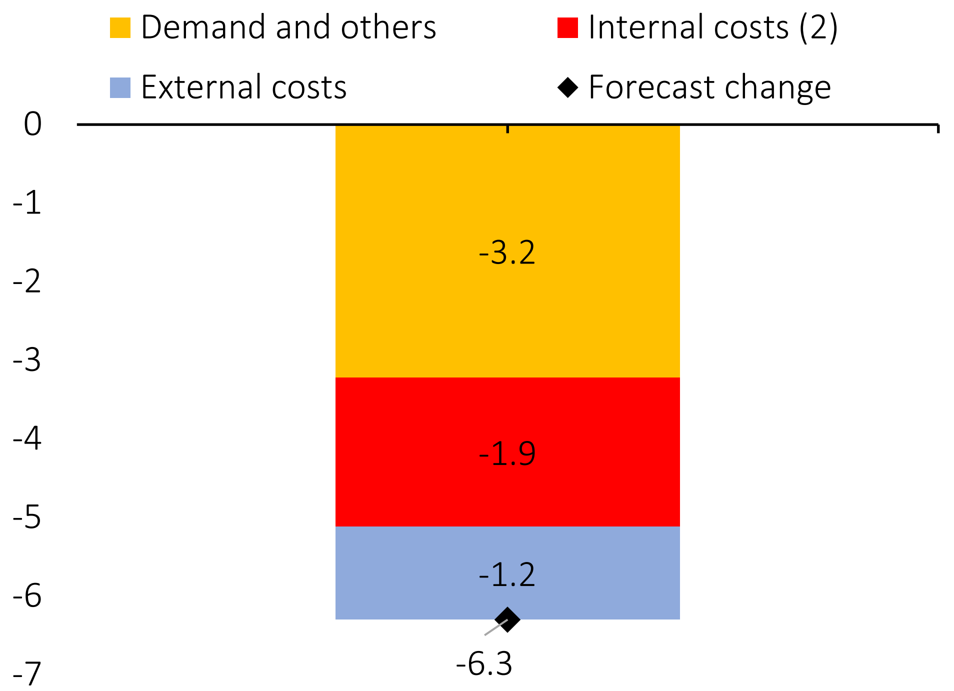


(*) Gray area, as from first quarter 2022, shows forecast.
Sources: Central Bank of Chile and National Statistics Institute (INE).

One key factor behind this forecast is the slowdown in domestic spending. Another is the reversal of the commodity-price-related cost shock.

Change in annual inflation forecast between 3Q2022 and 1Q2024 (1)

(percentage points)



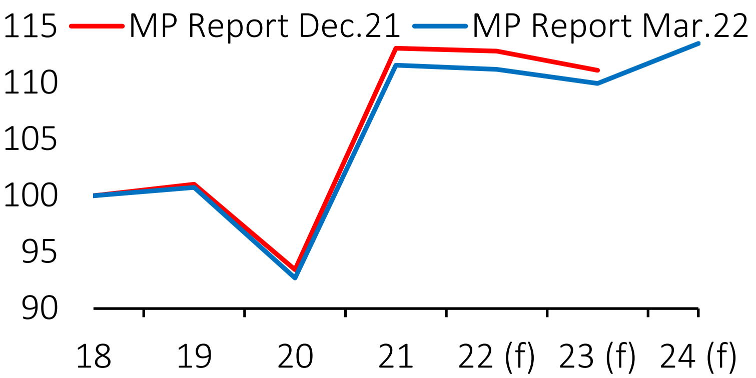
(1) Variation considers central scenario projections in this MP Report. (2) Includes the effect of exchange rate variations. Source: Central Bank of Chile.

This forecast is based on:

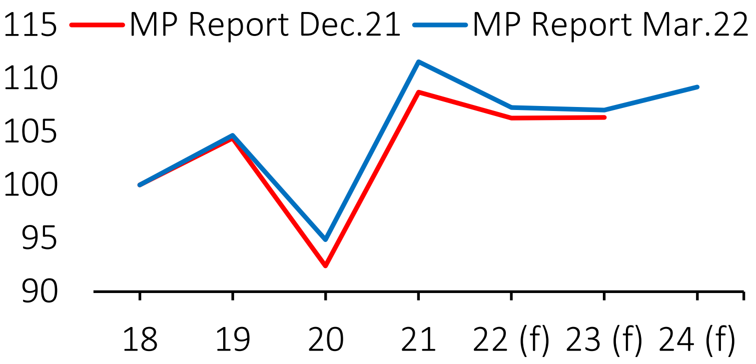
- Slowdown in domestic sepending due to withdrawal of macroeconomic incentives
- Decrease in commodity prices, leaving high base effect and lowering business costs
- Reorganization and restructuring of local and global supply chains, which will also reduce associated costs.

Convergence of inflation to target over the two-year horizon requires adjusting the overspending observed in 2021. Both consumption and investment will contract in 2022 and 2023. There are differences with the market projections.

Private consumption
(index, 2018=100)



Investment (GFCF)
(index, 2018=100)



This forecast is based on:

- High comparison base left from last year
- Reduced liquidity accumulated in last few quarters
- Less credit available

This forecast is based on:

- Tighter financial conditions
- Persistence of higher uncertainty
- Real exchange rate remaining above historical averages for several months

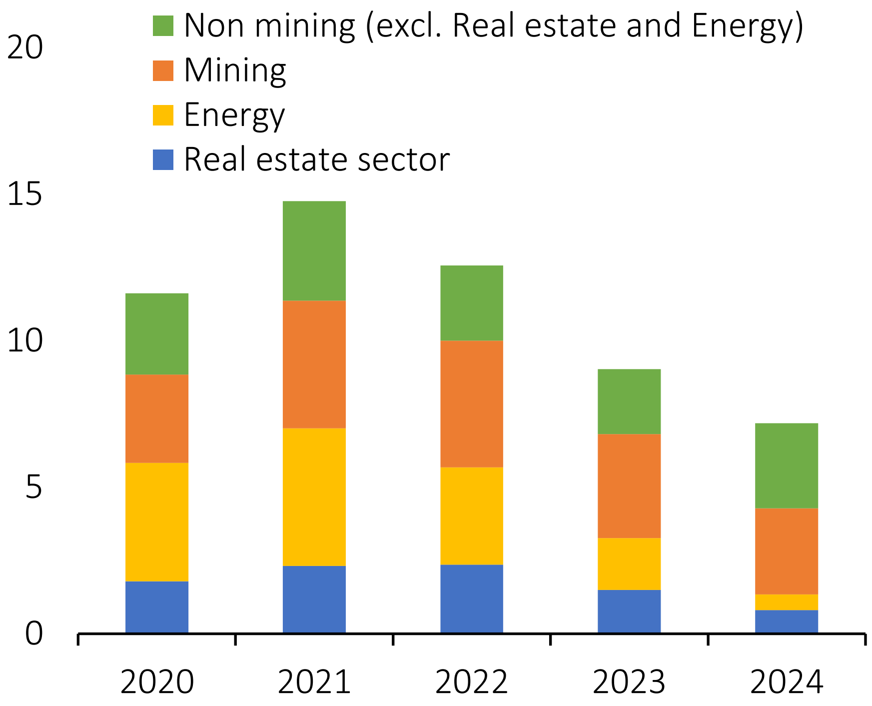
Projected private consumption and GFCF (*)
(annual change, percent)

	GFCF		Private consumption	
	2022	2023	2022	2023
EES March 2022	0.5	1.3	1.5	1.2
Consensus Forecast March 2022	1.4	0.6	2.2	0.6
MP Report March 2022	-3.8	-0.2	-0.3	-1.1

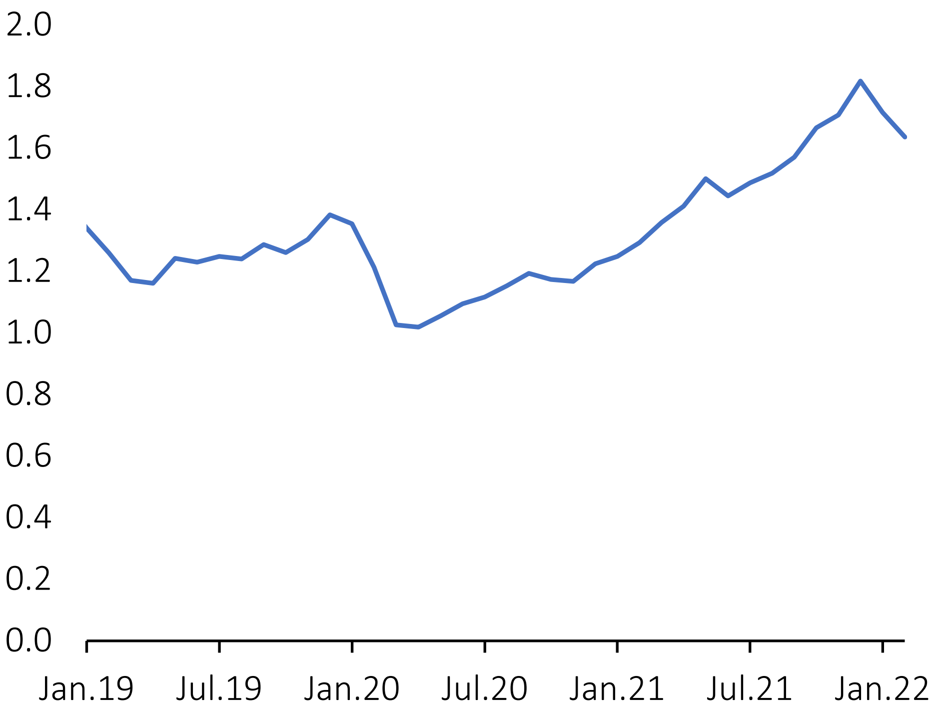
(f) Forecast. (*) The EES considers the median of the projections, while Consensus Forecast uses the mean. In both cases, they correspond to March 2022 measurements. Sources: Central Bank of Chile and Consensus Forecast

Investment posts the biggest correction with respect to December. The surveys and other sources reinforce the outlook of further weakening, especially in construction and works.

CBC: Total investment
(billions of dollars)



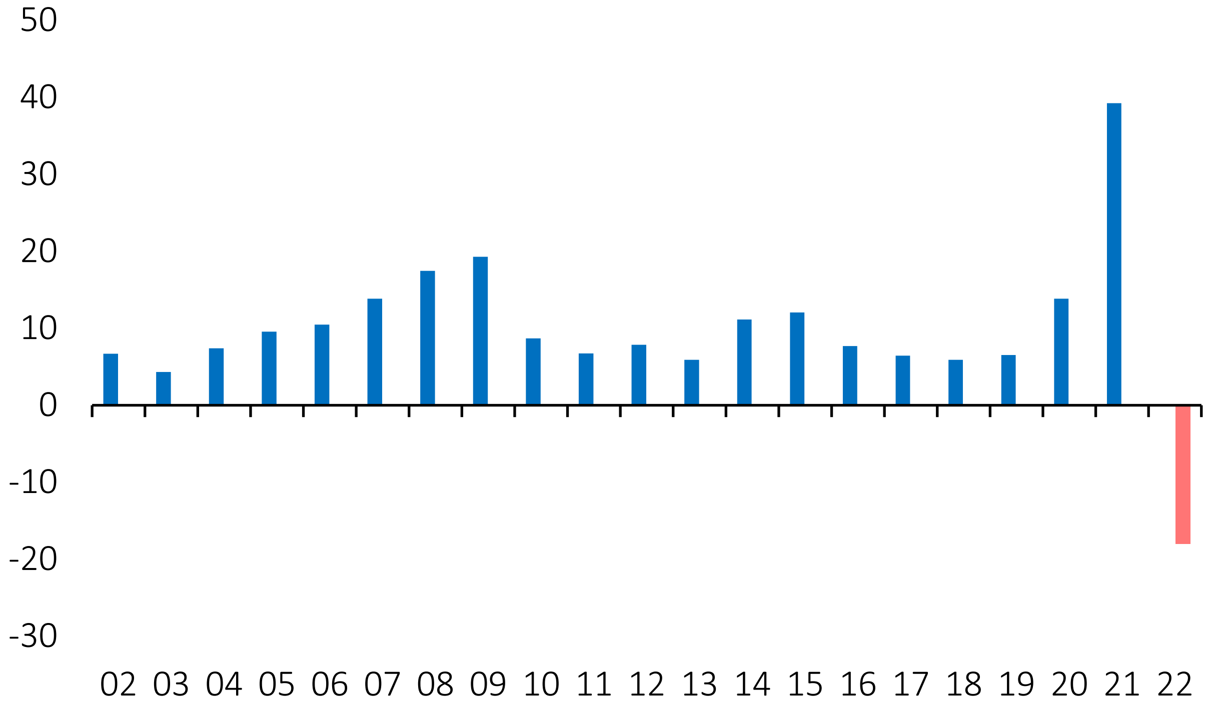
Nominal imports of capital goods
(billions of CIF dollars, moving 3-month average)



Sources: Central Bank of Chile and Capital Goods Corporation (CBC).

On the fiscal side, the central scenario assumes that public spending will be reduced this year as proposed in the approved budget.

Actual fiscal spending and 2022 forecast
(annual nominal growth, percent)



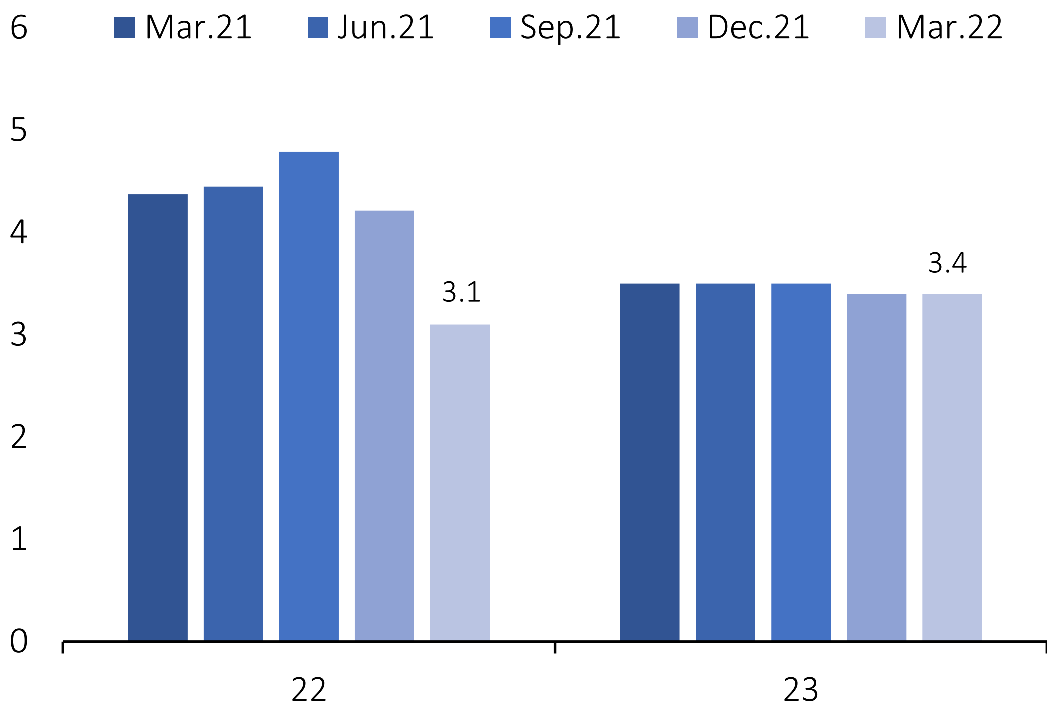
This forecast is based on:

- Reduction in government spending this year according to approved budget
- Spending trajectory in the 2023-2026 period consistent with the structural balance target
- During second quarter, the government is to publish its decree on fiscal responsibility, which will be key for the revision of these assumptions

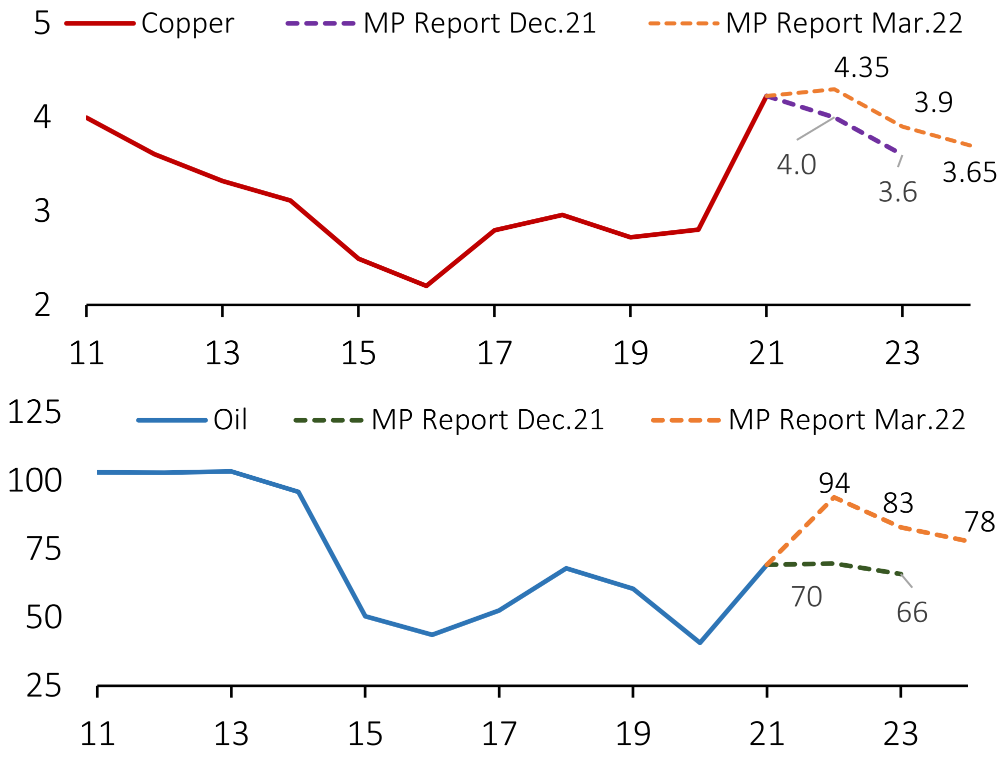
Sources: Central Bank of Chile and Budget Directorate (Dipres) of the Finance Ministry.

On the external front, these projections consider a decline in world growth and a worsening of the terms of trade, amid the uncertainty added by the war conflict.

World growth forecast
(annual change, percent)



Actual and projected prices (1) (2)
(dollars per pound; dollars per barrel)



(1) Actual prices refer to the average for each year. Dotted lines indicate the 2022-2024 projections contained in the respective MP Report. (2) For crude oil, WTI-Brent average price per barrel.
Sources: Central Bank of Chile and Bloomberg.

All these factors combined will cause GDP to contract through several quarters. Activity will resume near-potential growth by 2024.

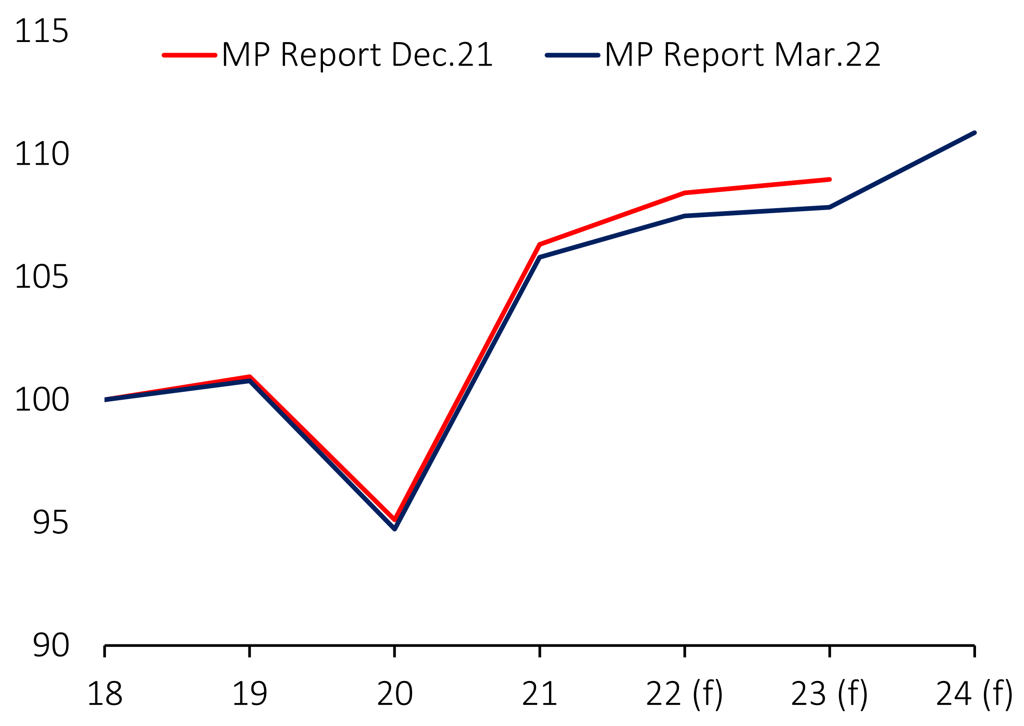
GDP growth forecast (1)

(annual change, percent)

	December 2021	March 2022
2022	1.5% – 2.5%	1.0% – 2.0%
2023	0.0% – 1.0%	-0.25% – 0.75 %
2024		2.25 % – 3.25 %

GDP forecast (2)

(index, 2018=100)

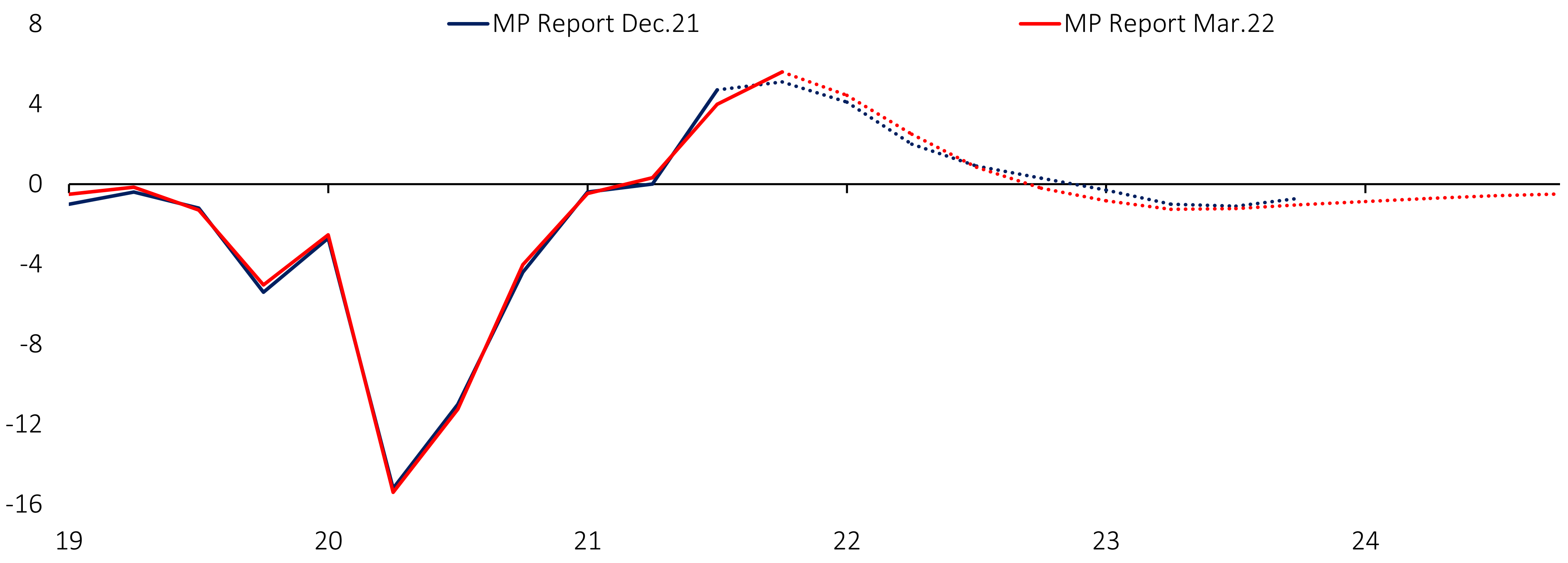


(1) Forecasts contained in respective MP Report. Arrows indicate change from December 2021 projection. (f) Forecast. (2) Forecasts consider midpoint of the growth ranges contained in this MP Report. Source: Central Bank of Chile.

Thus the gradual narrowing of the gap will continue.

Activity gaps (1) (2)

(level, percentage points)



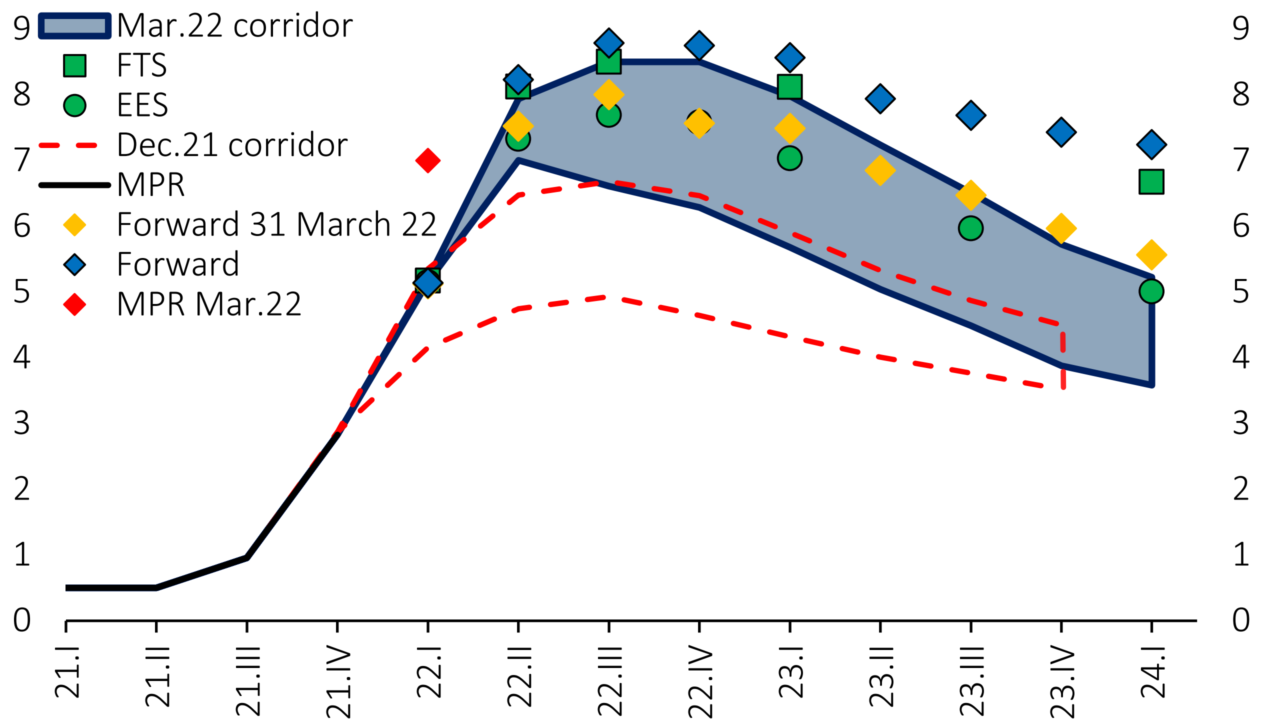
(1) Dotted lines indicate forecasts. (2) Forecast uses structural parameters updated in the June 2021 Monetary Policy Report. Source: Central Bank of Chile.

Monetary policy

The Board has rapidly raised the MPR in response to the higher inflation scenario. Going forward, if the central scenario proves correct, the increases would be smaller than those of recent quarters.

MPR corridor (*)

(quarterly average, percent)

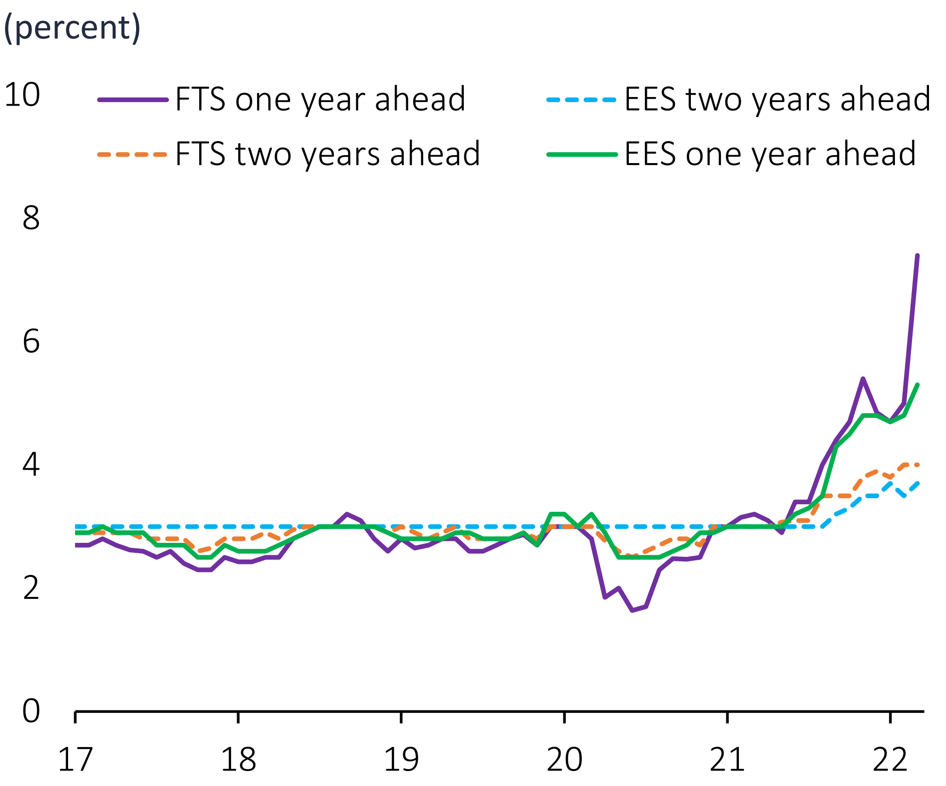


- The current MPR corridor runs between 100 and 200 basis points above that proposed in the previous MP Report
- The greater increment in the MPR will contribute to the normalization of domestic spending and an earlier closing of the activity gap
- While the increase in the MPR has been rapid and significant, risks to inflation convergence remain. The Board will monitor them carefully, ensuring that inflation converges to the target within the two-year monetary policy horizon.

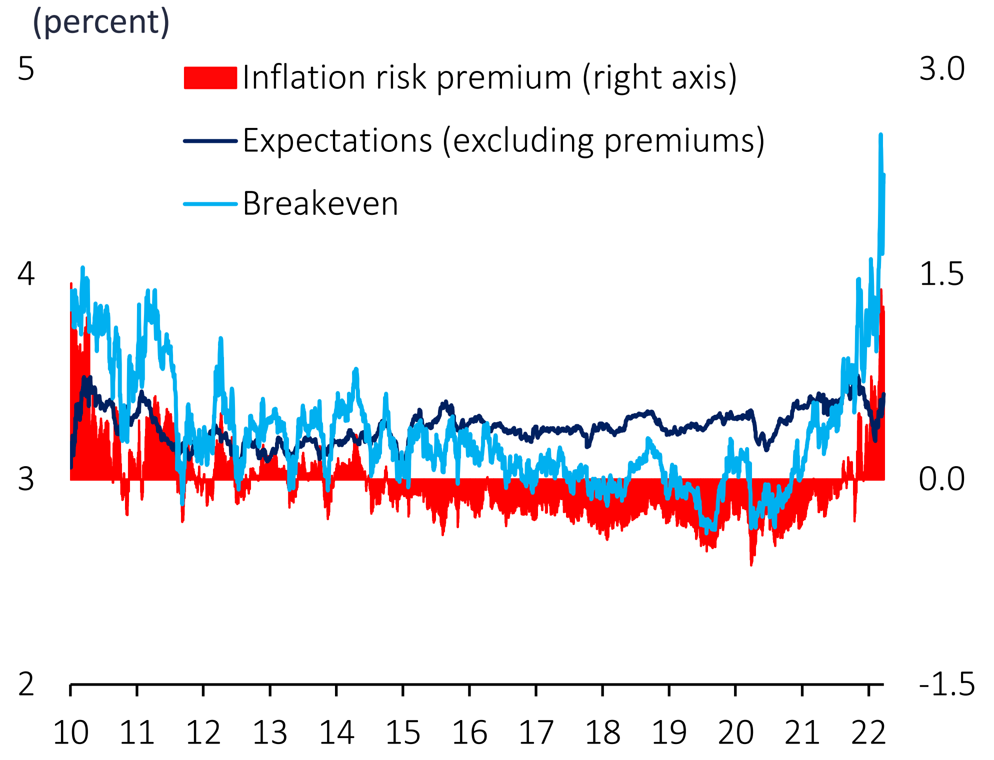
(*) The corridor is constructed following the methodology of box V.1 of the March 2020 Report and box V.3 of the March 2022 Report. Includes March EES and FTS previous to March MP meeting and the quarterly average smoothed forward curve at March 23rd. This is calculated by extracting the implicit MPR considering the forward curve on the interest rate swap curve up to 2 years, discounting the fixed rates at every maturity at the simple accrual of the ICP. For the current quarter the surveys and the forwards consider the average daily effective and are completed with the respective sources. Source: Central Bank of Chile.

Market inflation expectations remain above 3% annually in the two-year term. Breakeven inflation also shows high figures, although their levels are clouded by premiums which, when discounted, reduce them significantly.

Inflation expectations in surveys (1)



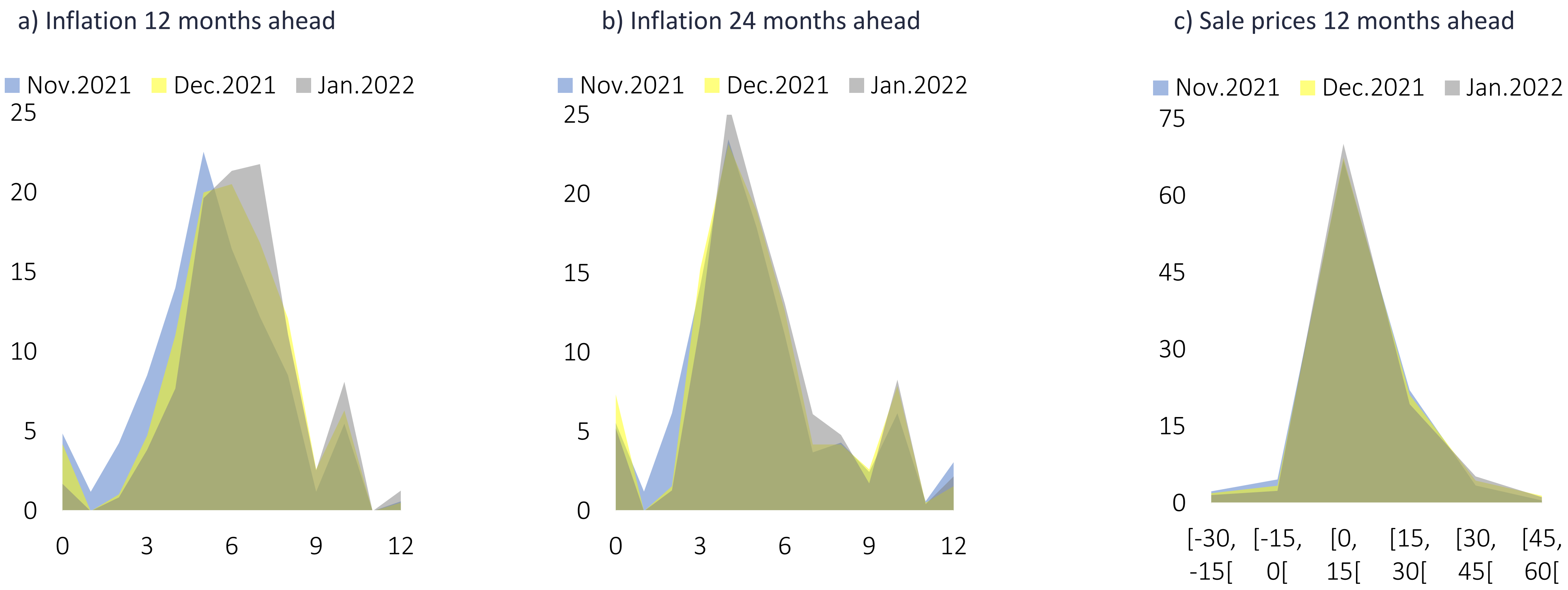
Decomposition of 10-year breakeven inflation (2)



(1) The FTS considers the survey of the first half of each month until January 2018. From February 2018 onwards, it considers the latest survey published in the month. (2) Estimates based on Beyzaga and Ceballos (2016), Abrahams et al. (2016) with SPC rates.
Sources: Central Bank of Chile y RiskAmerica.

Measures based on companies' perceptions show that their one-year inflation expectations have risen in recent months. But this is not as evident in two-year expectations or in expectations of their own prices.

Distribution of inflation expectations and sale prices
(percent)



Source: Survey of Price Determinants and Expectations, Central Bank of Chile.

There are also sensitivity scenarios that may require a milder monetary policy action than that in the central scenario.

Sensitivity scenarios

MPR lower than in central scenario

Possible reasons:

- Sharper-than-expected contraction of domestic demand and activity.
- Global uncertainty negatively affecting external and local demand, especially investment.

Implications:

- Lower inflationary pressures
- More gradual contraction of monetary stimulus

MPR higher than in central scenario

Possible reasons :

- Inflation expectations remain high for a longer period of time.
- Smaller than expected reduction in public spending.
- War conflict intensifies supply constraints or dismantles supply chains.

Implications:

- Higher inflationary pressures
- Stronger monetary policy reaction

There are risk scenarios where changes in the economy would be more significant and would require a policy response that exceeds the boundaries of the MPR corridor.

Risk scenarios

More damaging impacts on the world economy from the war in Ukraine.

- Global economic slowdown or recession.
- Significant worsening of financial conditions facing emerging economies.

Implications:

- High uncertainty surrounding the conflict makes it difficult to foresee which effects would predominate in MPR decisions.

The Board estimates that, if the assumptions in the central scenario prove correct, future increases in the MPR would be smaller than those of recent quarters. Although the MPR increases have been fast and significant, the risks for the convergence of inflation still persist. The Board will carefully monitor these risks, making sure that inflation converges to the target within the two-year monetary policy horizon.

Domestic spending continues to be the main factor behind the higher inflation, which has been compounded by greater cost pressures. These elements have continued to put upward pressure on prices, especially for goods. As a result, in December inflation was higher than expected.

The significant boost to domestic spending resulting from the various income-support measures led to an excessive increase in domestic demand, creating significant imbalances in the economy. Resolving these imbalances is key for inflation to come down and for activity to resume sustainable growth.

There are several risks that could compromise the resolution of these imbalances. If the factors that have led to higher inflation are not controlled in a timely manner, the problem could become more complex and its costs higher. The invasion of Ukraine also adds risks, given the uncertainty about its evolution and effects.

The Central Bank of Chile will remain vigilant to the evolution of inflation, always concerned about people's welfare. The Board has continued to raise the monetary policy rate in order to encourage people to save and contain spending. This will help prices to grow again at a slower pace, as they have in the past.

Upcoming presentations of the Monetary Policy Report

04 April	Elías Albagli	Pontificia Universidad Católica
05 April	Alberto Naudon	Universidad Andrés Bello
07 April	Pablo García	Junta de Adelanto del Maule and Universidad de Talca
19 April	Luis Felipe Céspedes	CORPROA - Copiapó

For clarification of the terms used in the presentation, please visit our Economic Glossary.

Upcoming economic events

1 April	February’s Imacec
12 April	Economic Expectations Survey - April
13 April	Minutes of March monetary policy meeting
18 April	Nat. Accounts by institutional sector – 4th quarter 2021
18 April	Financial Traders Survey post policy meeting - April
2 May	March’s Imacec
2 May	Financial Traders Survey pre policy meeting - May
3 May	Business Perceptions Report - May
4-5 May	Monetary policy meeting - May

For details, please visit our Calendar of economic events.

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MONETARY POLICY REPORT

MARCH 2022

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