

EXTERNAL SCENARIO AND MONETARY POLICY

CXIV Governors Meeting – Spring - CEMLA

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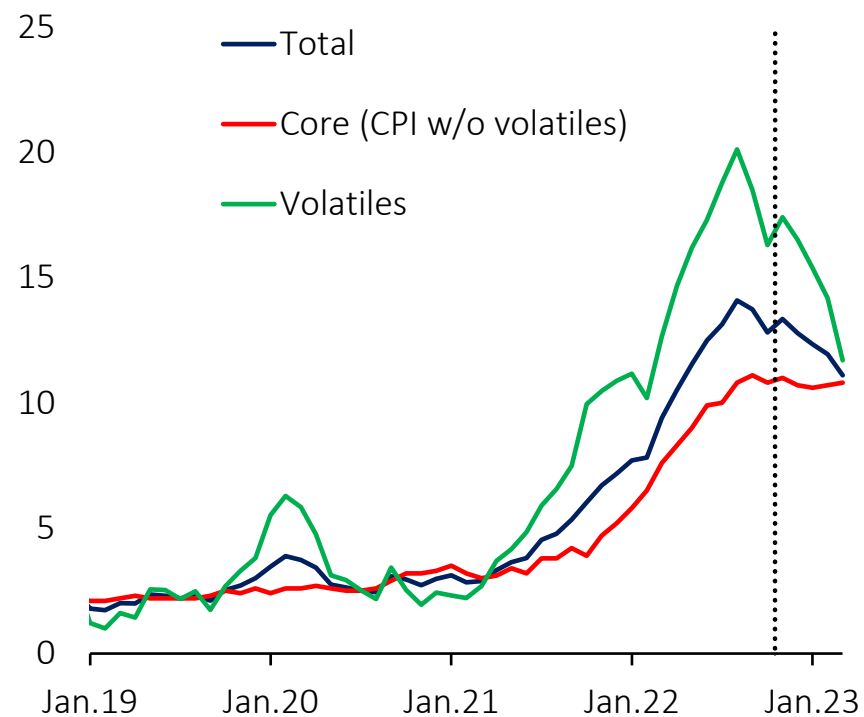
PASEO PEATONAL FRUTILLAR
Región de Los Lagos

Chile inflation remains very high, with a core CPI around 11% from several months. Latest forecast (March MP Report) shows that total and core inflation will reach the 3% target over the last part of two years MP horizon.



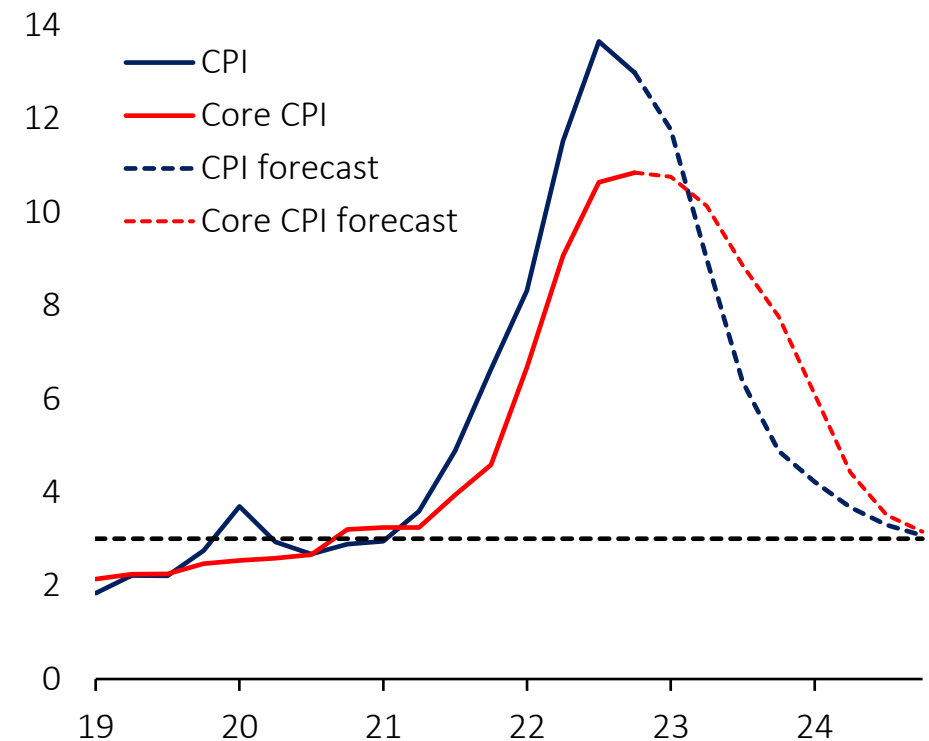
Inflation indicators (1)(2)

(annual change, percent)



Total and forecast inflation (3)

(annual change, percent)

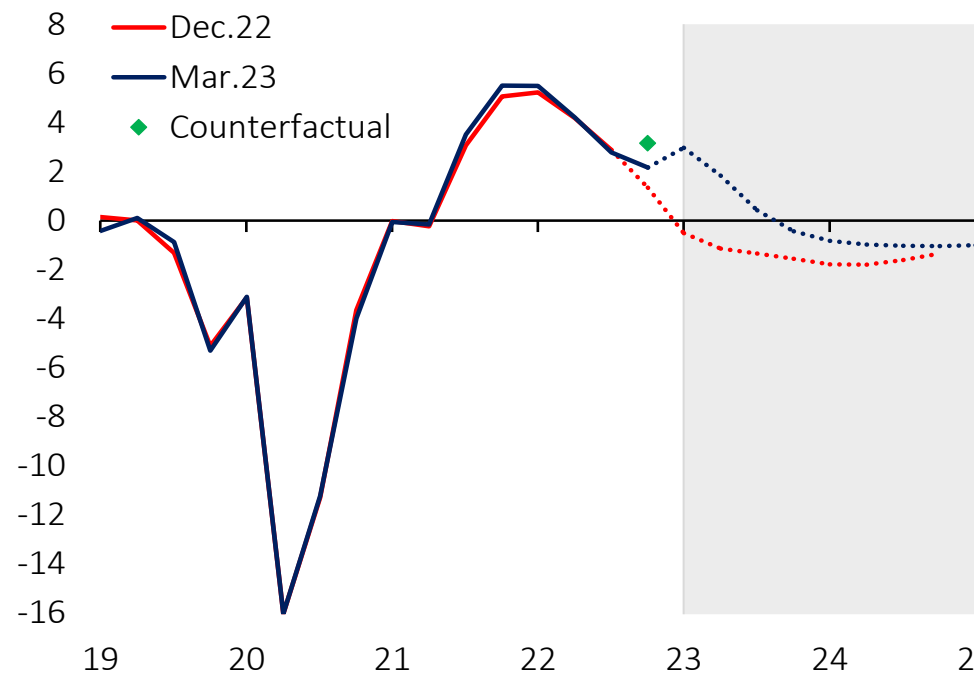


(1) Dotted vertical line marks statistical cut-off of December 2022 MP Report. (2) For details on groupings and their shares in total CPI basket, see [box IV.1 in December 2019 MP Report](#), [Carlomagno and Sansone \(2019\)](#), and [Economic Glossary](#). (3) As from the first quarter of 2023, slashed lines shows forecast in March 2023 MP Report. Sources: Central Bank of Chile and National Statistics Institute.

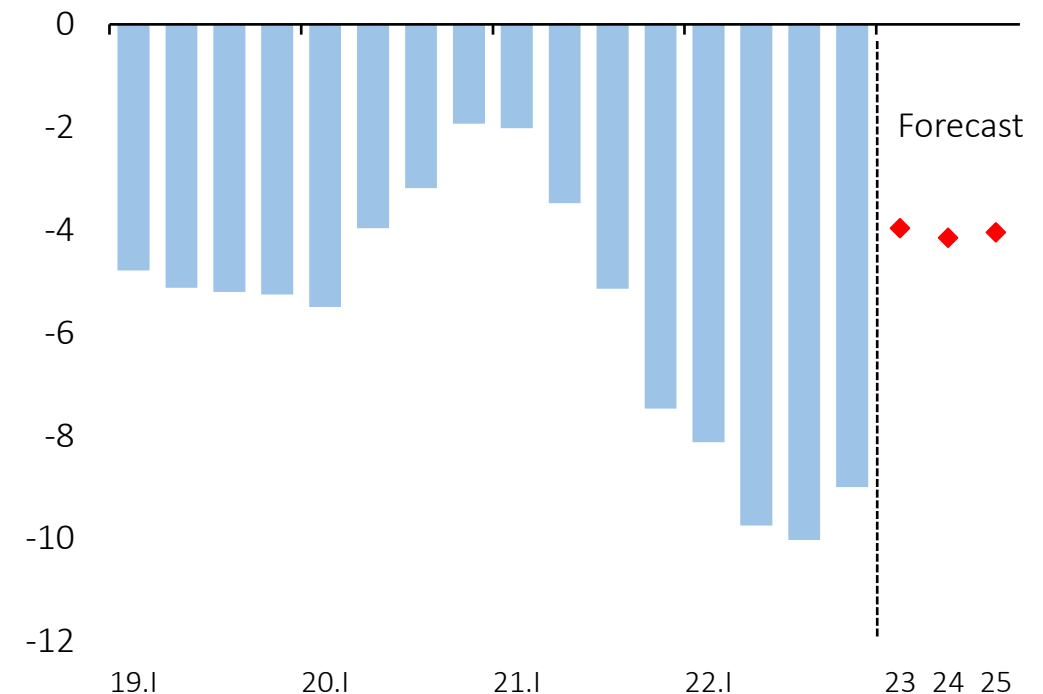
The adjustment of the local economy is still one of the key assumptions behind the convergence of inflation. This implies a negative output gap for several quarters and a relevant improve in current account deficit.



Activity gap (1) (2) (3)
(level, percentage points)



Current account (4)
(percent of GDP, last twelve months)



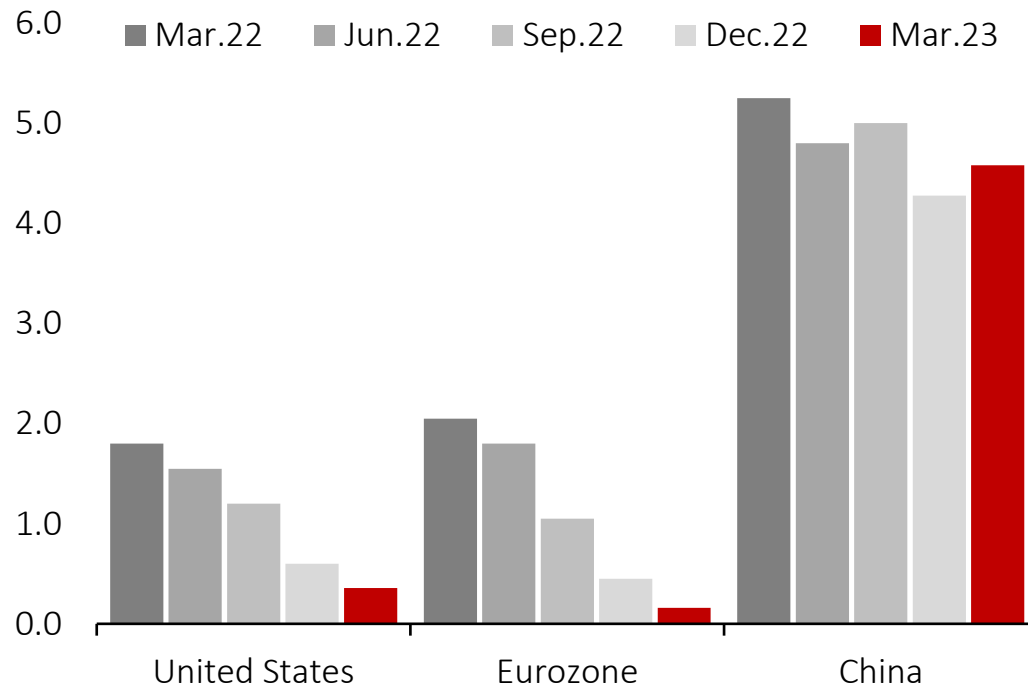
(1) Constructed using seasonally adjusted data. Dotted lines show forecasts. (2) Projection uses structural parameters updated in the December 2022 MP Report (trend) with methodological revision of potential GDP. (3) Counterfactual for 2022.Q4 estimated assuming that the value added measure of the Transport sector remains at its level of 2022.Q3, which is equivalent to zero velocity. All other non-mining sectors use published velocities. For the fourth quarter, both the effective and counterfactual gaps are calculated using the same potential GDP. (4) Quarterly effective data. Red diamonds show forecasts for respective years. Source: Central Bank of Chile.

In the external side, our forecast consider that recent financial events will deteriorate global financial conditions, more affecting growth in developed economies. Terms of trade will be better this year, due the China's recovery.



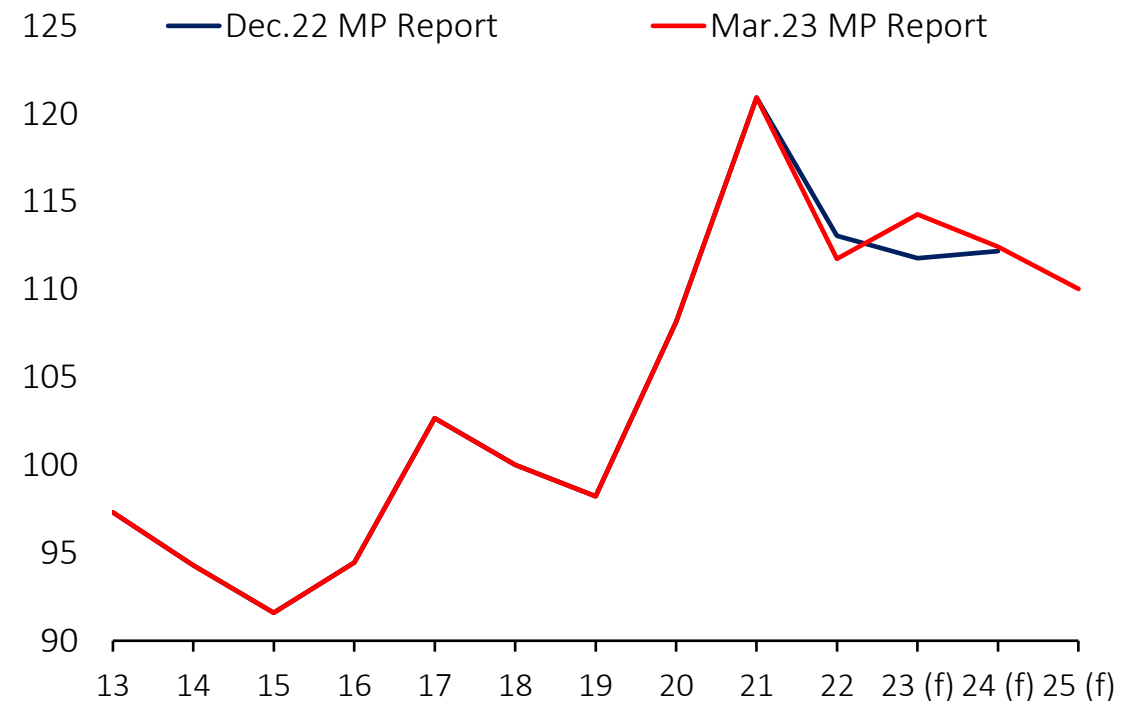
World growth forecasts for 2023-2024 (*)

(annual change, percent)



Terms of trade

(level, 2018=100)



(*) Average of both years. (f) Forecast.

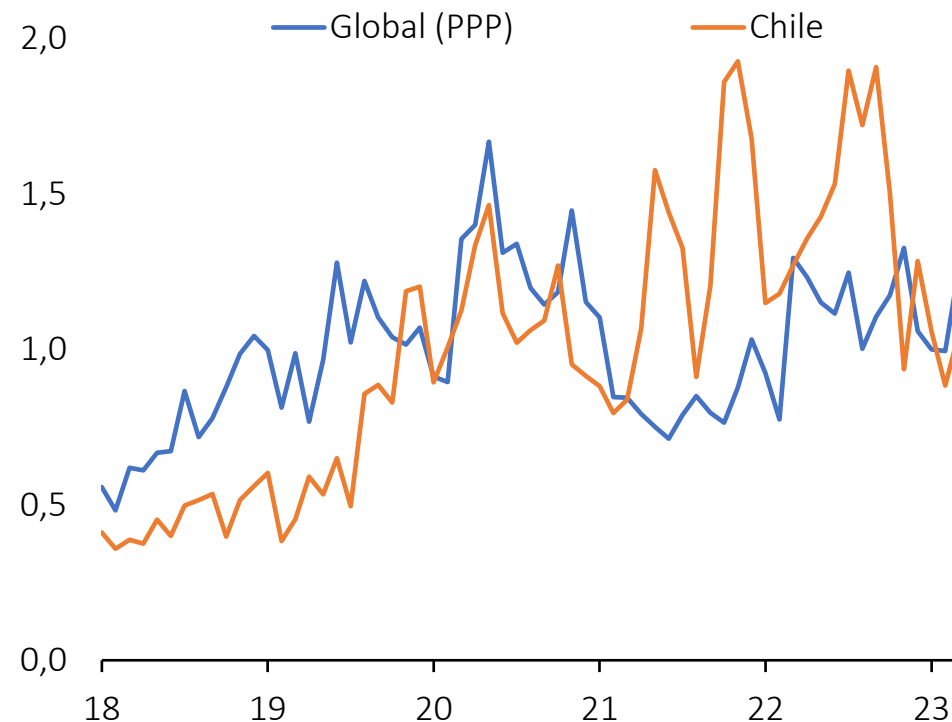
Sources: Central Bank of Chile and Bloomberg.

Domestically, uncertainty has been significantly reduced over the last quarters, returning to levels similar to was observed prior October 2019. Decomposition of long-term interest rate shows a higher impact of external than internal uncertainty.



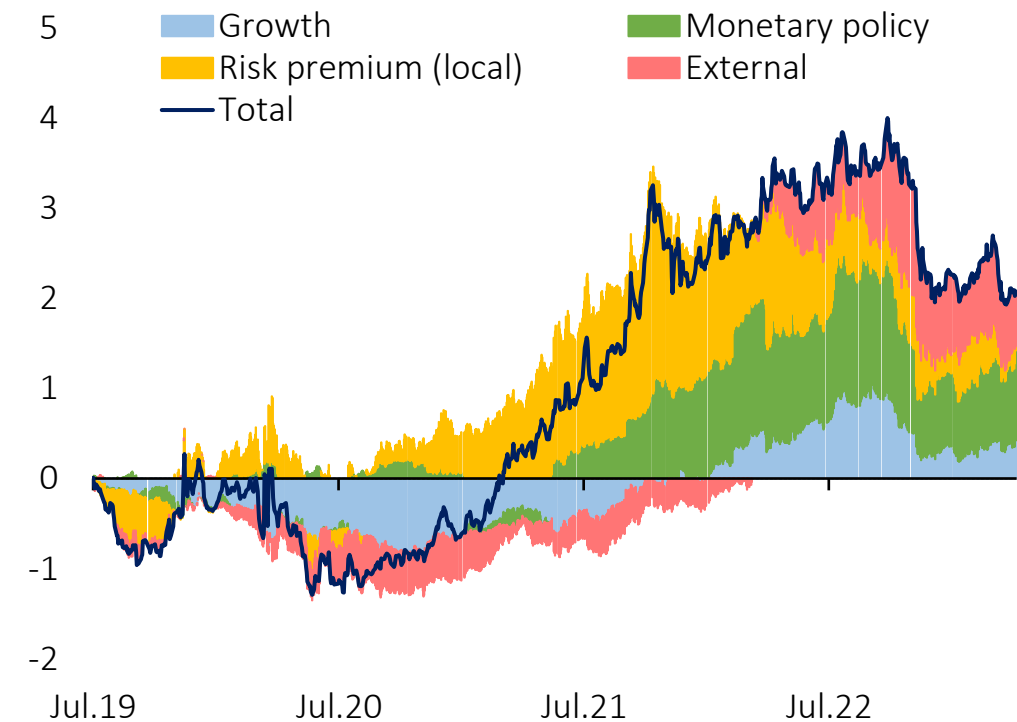
Uncertainty

(index, average 2018-2023=1)



Structural decomposition of 10-year zero rate (*)

(basis points, accumulated since 1.Jul.2019)



(*) Historical decomposition of the long rate from a BVAR based on the identification strategy proposed by [Eterovic and Eterovic \(2022\)](#), incorporating an external block. The exogenous block encompasses all U.S. shocks (i.e., monetary policy, economic growth, risk aversion and pure risk), which have been aggregated for simplicity.

Sources: Central Bank of Chile, Bloomberg and Economic Policy Uncertainty.

Regarding financial issues, the Chilean banking system is subject to adequate regulation and supervision, which prevents the occurrence of episodes like those that triggered the current uncertainty.



The dominant banking business model in Chile is traditional in nature. It is focused on granting credit on a more diversified basis of financing and adequate management of term mismatches.



The regulatory framework has been updated and considers Basel III capital and liquidity standards for all banks.



Every bank is subject to comprehensive annual supervisory processes for risk management, capital adequacy, liquidity and transparency.

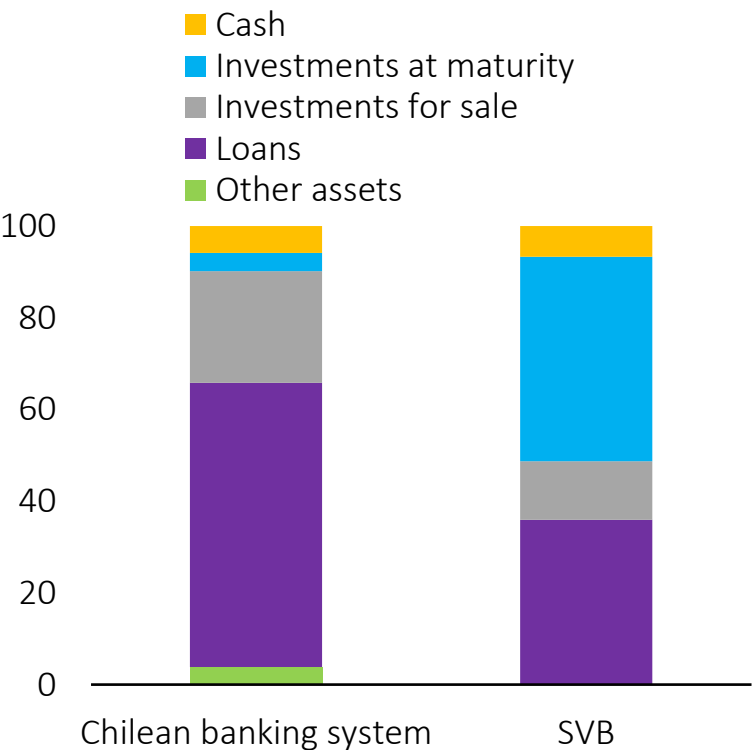


Both the Central Bank and the Commission for the Financial Market (CMF) monitor on a permanent basis the banks' capacity to withstand adverse events by conducting stress tests.

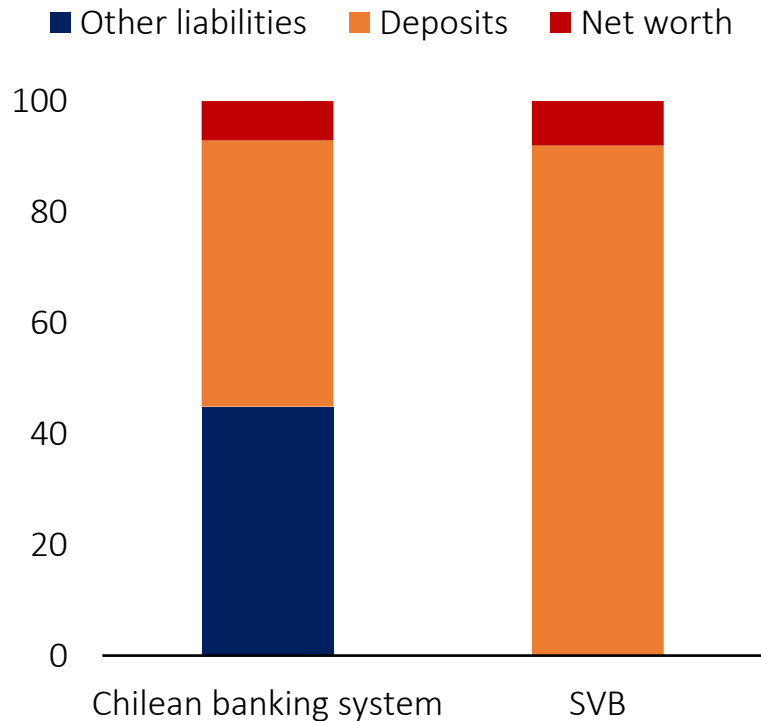
The banking business operates in a traditional model. It is focused on granting credit on a diversified financing basis and adequate mismatch management.



Asset composition (*)
(percent of total assets)



Liability composition
(percent of total liabilities)



(*) Assets in Chile's banking system (CMF)

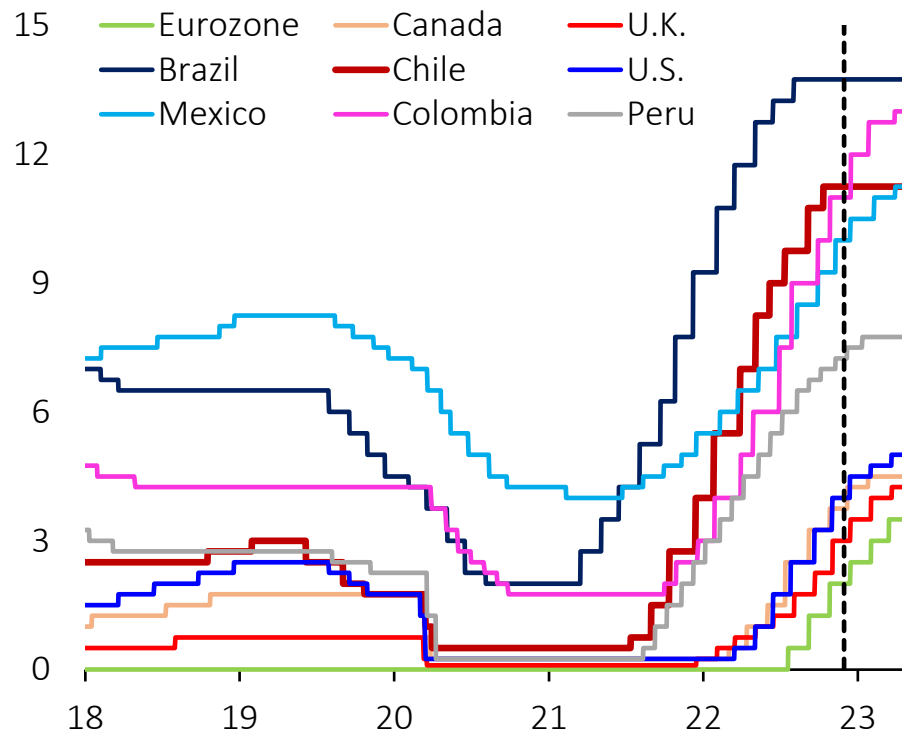
- Cash: cash and bank deposits
- Investments at maturity: debt instruments at amortized cost
- Investments for sale: debt instruments at reasonable value and derivative instruments
- Loans: commercial credits, lending to persons (consumer and housing), owed by banks
- Other assets: deposits at BCCh, rights under agreements (repo and securities lending), intangible assets, fixed assets and others.

Sources: Commission for the Financial Market (CMF) and U.S. Securities and Exchange Commission (SEC).

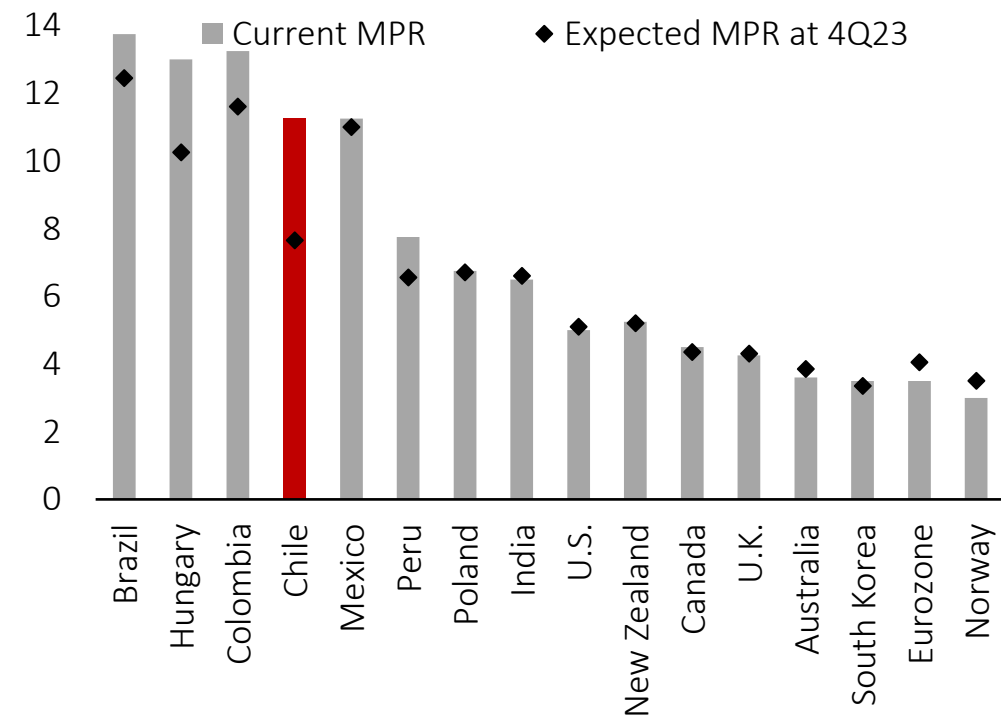
Although inflation is very high, the Chilean MP has made a rapid and significant adjustment. In fact, both the projections of the MP report and market expectations do not consider that there is a pending task regarding rate hikes.



Monetary policy interest rates (*)
(percentage points)



Global MPRs and expectations
(percentage points)

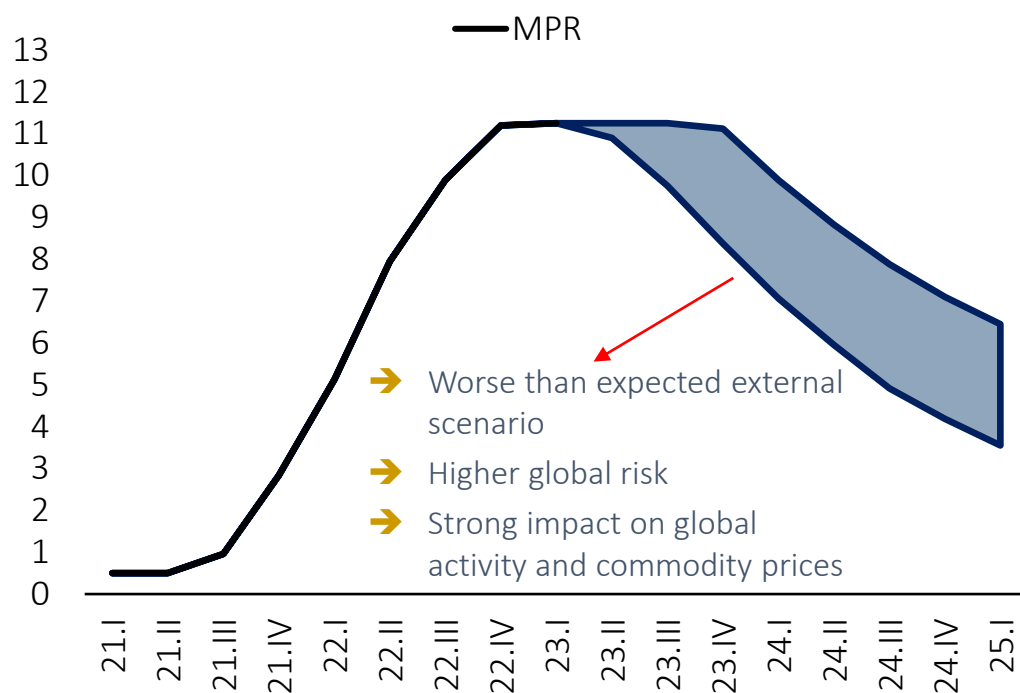


(*) Dotted vertical line marks statistical cut-off of December 2022 MP Report.
Source: Bloomberg.

In central scenario, MPR will remain at 11.25% until macroeconomic conditions indicate that the process of inflation convergence to the 3% target has been consolidated. Nonetheless we consider scenarios where the pace at which inflation will return to the target is somewhat different, one of them is related to a worst external environment.



MPR corridor (*)
(quarterly average, percent)



Although its probability seems low for now, there is also the possibility of a much worse financial scenario (similar to GFC 2008/2009).

We assume this situation as a risk, whose effect on inflation and the MPR is very different from what occurs in the corridor.

In addition, the risk of more persistent inflation is just as important as a greater deterioration in the external scenario. With the caveat that the impacts of one and the other are asymmetric in the inflationary convergence.

The Board has compromised his flexibility in order to react to external or internal risks.

(*) The corridor is constructed following the methodology of [box V.1 of the March 2020 MP Report](#) and [box V.3 of the March 2022 MP Report](#). For details, see methodological note (figure II.1, chapter II, March 2023 Monetary Policy Report). Source: Central Bank of Chile.



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