banco central Chile

MONETARY POLICY REPORT

MARCH 2021

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The Central Bank of Chile's Monetary Policy

Money plays a fundamental role in the proper functioning of any economy. To preserve such role, the monetary policy of the Central Bank of Chile (CBCh) must protect the value of the national currency —the peso—, in its quest to keep inflation low and stable. Achieving this fosters the population's wellbeing by safeguarding their income's purchasing power and making the economy function better. When inflation is low and stable, monetary policy can also moderate fluctuations in employment and production.

The inflation target and the monetary policy interest rate (MPR)

The Bank conducts its monetary policy seeking that, irrespective of the current level of inflation, its forecast for a two-year horizon will be 3%. This is similar to the practice of other countries in the world that have, as does Chile, a floating exchange rate; this is the so-called inflation targeting scheme.

The MPR is the main instrument used by the Bank to achieve the inflation target. Its level is decided at the Monetary Policy Meeting, which is held eight times a year. In practice, the MPR is a reference interest rate to determine the cost of money and other financial prices, such as the exchange rate, and longer-term interest rates, among others. In turn, these variables affect the demand for goods and services and, thereby, prices and inflation. Monetary policy decisions take several quarters to be fully reflected in the economy, which warrants that monetary policy be made from a forward-looking point of view, having as its primary focus the inflation projection two years ahead, and not just today's inflation.

Communication, transparency and the Monetary Policy Report

Since the Central Bank makes its monetary policy decisions autonomously, it must constantly account for them and their results to the general public. This is so not only because it is a government agency within a democratic society, but also because a credible monetary policy, understood by the people, helps to keep inflation low and stable. Through the Monetary Policy Report (MP Report), the Bank communicates to the general public its view of the recent evolution of the economy, its projections for the coming years and the way in which, in this context, it will conduct monetary policy in order to meet the inflation target.

The MP Report is published four times a year (every March, June, September, and December) and is put together by a team of around 60 persons.

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(*) This Monetary Policy Report's statistical cutoff date was 24 March 2021, except where otherwise indicated herein. The Report also takes into account the monetary policy decision announced on 30 March. This document was originally written in Spanish. In case of discrepancy or difference in interpretation, the Spanish version prevails.

SUMMARY

The Chilean economy has been steadily recovering from the major shock caused by the pandemic. It ended the year 2020 showing greater dynamism than anticipated, supported by better adapted companies and households and a substantial monetary and fiscal impulse. Thus, although a setback in local activity is foreseen in the weeks ahead due to the tightening of sanitary measures, the outlook for 2021 has strengthened, also supported by sustained progress of the vaccination process, the greater external impulse and the continuation of expansionary policies. There are still important risks, however, related to this unprecedented shock. On the one hand, the epidemiological evolution is still complex, which adds uncertainty as to when and how the sanitary restrictions in place will be relaxed. On the other hand, the recovery continues to be heterogeneous, with significant lags in those sectors more dependent on human interaction, which helps to explain the big gaps that persist in the labor market. At the global level, the correct calibration of monetary and fiscal stimuli in terms of their size, magnitude and permanence is key, in order to support the recovery without generating macro-financial imbalances. Equally important are the scars that the pandemic will leave on households and businesses (including the deterioration of their financial situation) and its impact on the future dynamism of the economy.

Despite advances in Chile's economic recovery, differences persist across sectors. GDP closed 2020 with an annual decline of 5.8%, at the better end of the December forecast for the decline range. End-2020 data indicate that a good part of GDP's 13% drop of the second quarter was reversed, and incoming data suggest that this trend continued at least until mid-March. By sector, the evolution of trade stands out, while activities that require greater social interaction or where telecommuting is less viable continue to lag behind the rest of the economy.

The fact that an increasing number of firms have managed to adapt to pandemic-related work conditions has been key in the improved performance of the economy. After the outbreak of the sanitary emergency, many social distancing measures were taken that hindered or halted the operation of several economic activities. With time, firms and households have been able to adapt to the constraints, helped by the strong development of online sale channels —something that helped sustaining the good performance of trade—, remote work, logistic services and the adoption of several norms that permit to operate while protecting workers from being infected. These adjustments have allowed several of the companies that suspended activities at the beginning of the pandemic to resume them, thus recovering commercial relations between companies and contributing to the recovery of the labor market.

There is also unprecedented support from macroeconomic policy, which has used up the slack accumulated in previous years to shore up workers, households and firms. In the case of the Central Bank, this has translated into some twenty measures aimed at boosting the monetary impulse, stimulate credit, ease the adjustment of financial markets and recover part of the policy space to deal with new risks. The monetary policy rate (MPR) completed a year at its technical lowest while unconventional measures have mobilized resources of 13% of GDP. This has allowed the economy to navigate this crisis having a countercyclical credit behavior and interest rates at historical lows.

The Chilean economy has also benefited from the international scenario, which has recovered faster than expected, and in which the strong monetary and fiscal stimuli have also played an important role. The rapid improvement of the economies of China and other trading partners have boosted Chilean exports. The copper price has peaked above US$4 per pound —its highest since 2011—, sustained by increased global industrial production and low inventory levels in the stock exchanges. The central scenario central estimates that its price will stay above its medium-term level throughout the projection horizon. In this context, valued exports rose significantly in the second half of 2020.

Household spending dynamics have been determined by supply-side constraints —especially in services— together with income and liquidity support measures. Consumption contracted sharply in the second quarter of 2020 due to sanitary restrictions, lost jobs and high uncertainty about the effects of the pandemic. In the second part of the year, although important constraints were maintained in the services sectors, the tradable component of spending accelerated due to greater liquidity from pension savings withdrawals and the implementation of fiscal support measures. However, the drop in consumption outweighed the contraction in income, resulting in an increase in private savings that was only partially offset by the government's dissaving. This, together will the fall of investment, led to a significant reversal of the current account balance from a deficit of 3.7% of GDP in 2019 to a surplus of 1.4% of GDP in 2020.

Although economic recovery has been spreading out, the labor market still lags behind especially in some sectors. Although various sources of information point at employment further advancing in recent months, it is still below pre-pandemic levels. In any case, it is worth noting that both labor supply and demand have improved with respect to the middle of last year, with job offers increasing and inactivity decreasing. Regarding the latter, although the reasons associated with Covid-19 have receded, inactivity remains high for women who left paid employment to devote themselves to caring for children and other family members.

Investment has recovered more slowly than consumption, affected by the high uncertainty about the course of the pandemic and the financial burden on companies. During the second half of 2020 several of the large-scale projects that had been shelved were reactivated, and marginal data show more dynamic imports of capital goods. However, the speed of the recovery of investment has been slow and there is no significant acceleration of the private component in sight. The December survey of the Capital Goods Corporation showed a drop in investment expected this year compared with previous estimates, due to forsaken real-estate projects and rescheduled mining and industrial projects. The information contained in February's Business Perceptions Report indicates that investments are focalized in the renewal of existing machinery and equipment and process automation. Participants continue to respond that projects are marked by the uncertainty surrounding the evolution of the pandemic, demand perceived to be insufficient and increased corporate indebtedness.

As for financial conditions, global markets —Chile included— have reflected progress in economic recovery and improved expectations around the world. Accordingly, stock market indicators and long-term interest rates have risen in various economies. Chile has echoed these tendencies so, as activity has rebounded and the outlook has improved, 10-year BCP rates have risen around 100 basis points from the turn of 2021. Although the steepening of the yield curve is a natural response to the global recovery, some economies have begun to question whether the size of the monetary and fiscal stimulus measures currently in place is warranted. Worth highlighting is the case of the United States, where the recently approved massive fiscal package had an impact on interest rates due to its possible effects on inflation.

About credit, commercial loans posted lower annual growth rates compared with their peak of mid-2020, when firms were in need for emerging funding. In fact, the focus of demand for credit has shifted to debt refinancing needs, as the pandemic has continued longer. To support this process, the Government implemented Fogape-Reactiva, which was complemented by the Central Bank with Phase 3 of the Credit Facility Conditional on Increased Lending (FCIC). This facility began to operate on March 1 and, at the statistical cutoff of this Report, banks had used up around 15% of the US$10 billion made available in this third version. Personal loans have not changed its recent trends, with a sharp contraction of consumer credit and stable growth in mortgage credit. Interest rate levels are still bounded for all credit categories.

PROJECTIONS

Although in the immediate future a setback is expected due to the tightening of sanitary measures, the outlook for activity this year is higher than that forecast in the previous Report. This is explained by the better basis for comparison left by the economy between late 2020 and early 2021, the favorable global outlook and the fast progress of the vaccination campaign. The new evidence accumulated on the effects of the latter factor allows foreseeing that towards the second half of the year an advanced opening of the economy will take place. All this has translated into better expectations of companies and households, and higher private growth projections.

Our projection for 2021 growth is up with respect to December, with no significant change for the following years. In the central scenario, the growth projection for 2021 is raised to a range between 6.0% and 7.0% (5.5-6.5% in December), while for 2022 it remains between 3.0% and 4.0%. For 2023, it is between 2.5 and 3.5%, somewhat below the trend growth estimate. In any case, this latter estimate is highly uncertain, as the pandemic has caused significant effects in different areas, such as financial health, business productivity or the functionality of logistics chains, which could have varied effects on medium-term growth capacity. This situation will be assessed in the June Report, when the structural parameters of the economy will be updated. Projections in the central scenario assume that the impulse from abroad will continue to be positive, with the terms of trade around 10% higher than expected in December, and that the global economy will see a significant recovery in 2021. Regarding fiscal policy, it assumes that an important momentum will be maintained during this year, which will be reduced as the sanitary emergency subsides and progress is made in the fiscal consolidation process. Likewise, it considers that the constitutional debate will follow the expected institutional channels and that the severe episodes of violence will not be repeated. As for spending, a significant recovery in consumption is anticipated thanks to the opening of the economy and households' high liquidity availability. Somewhat greater dynamism is foreseen in public investment and investment linked to large-scale mining and energy projects, but no significant recovery is anticipated for non-mining corporate investment.

Inflation will post a transitory increase to nearly 4% in the coming months because of higher prices of energy and other volatile items, to begin converging to the policy target in the second half of the year. Inflation has been around 3% during the last months, with important fluctuations deriving from the particular conditions imposed by the pandemic on the availability of certain goods and services. Before starting to converge to 3%, annual inflation will be affected by the low price of oil in the second quarter of 2020, which, combined with its hikes of recent months, will bring the annual variation of the CPI to close to 4%. The appreciation of the peso from its levels at the end of last year will operate in the opposite direction. Core inflation (excluding volatile items) will fall to 2,6% towards year-end, and then return to 3%.

SENSITIVITIES AND RISKS

Despite the positive recent performance of our economy, several risks persist because of the exceptional nature of the Covid-19 shock. On one hand, the impact of the vaccination process still has a long road ahead before it is reflected in the pandemic's evolution and the sanitary measures. And there is also the possibility of new waves of infections and new strains. In Chile, the worsening of the sanitary situation has forced the total confinement of nearly 85% of the country's population, which will negatively affect the economy in the second quarter. Still, this effect will not be as bad as at the beginning of the pandemic, as firms and households have learned to adapt to these scenarios, constraints themselves have adjusted and public policies now have a toolkit to deal with the situation and mobilize aid for the most hardly affected. Although as the vaccination process unfolds restrictions should be rapidly lifted, a less favorable evolution of the virus cannot be ruled out, which could have repercussions on the more vulnerable activities and firms. Should such a scenario reduce the inflation outlook, monetary policy could remain at its lowest level for longer than assumed in the central scenario.

On the other hand, it is possible that the labor market and investment have a slower recovery. Despite the adaptive capacity that companies have demonstrated so far, factors such as increased uncertainty, impediments for companies to meet their financial commitments, longer-than-expected persistence of constraints or productivity losses, could have a greater impact than estimated. In such case, the recovery of investment and job creation would be slower. This, in turn, would have negative implications for activity, demand and inflation, which would make monetary normalization slower than considered in the central scenario.

There are also scenarios where short-term growth could exceed projections. It cannot be ruled out that, once herd immunity has been achieved and constraints on the functioning of several activities have been removed, the sharp increase in savings in liquid instruments that was accumulated over 2020 will be destined to consumption. Such situation would give way to a faster-than-expected closing of gaps, resulting in monetary normalization occurring sooner than assumed in the central scenario.

After considering all these sensitivity scenarios, the Board estimates that the risk balance for both inflation and activity is unbiased. In any case, the possibility of more negative risk scenarios is still present, in particular because of the sanitary evolution of the pandemic, the characteristics of the recovery of other economies, and the scars that will be left by this event.

The speed of economic recovery is being very uneven among economies, which could cause the withdrawal of incentives in the most advanced economies, such as the United States, to cause a complex tightening of financial conditions for the countries lagging behind in the process. Chile, like some of its main trading partners —China and the U.S.— has shown a faster than expected economic recovery process, combining the massive monetary and fiscal impulse and the prospects opened up by progress in vaccinations. Other economies, particularly several emerging markets, are still badly hit and with prospects of a delayed recovery. These differences pose a significant challenge as progress of the world economy makes it necessary to review stimulus measures and leads to a tightening of financial conditions for countries that are yet to complete their economic recovery. This risk becomes even more relevant if markets perceive that inflationary pressures are higher than anticipated and begin to factor into their decisions an imminent withdrawal of monetary stimulus in economies like the United States.

MONETARY POLICY

Going forward, it will be very important for monetary policy to distinguish between transitory price movements —caused by the dissimilar performance of economies and the markets' adjustments to this unprecedented shock— and more sustained increases in inflation. In the central scenario, activity and employment will continue to recover in Chile, with inflation at the 3% target two years ahead. In the meantime, projections show that inflation will see a transitory increase induced by the behavior of volatile prices. In fact, core inflation will fall to 2,6% towards year-end, and then return to 3%.

The Board considers that, even as the outlook for the economy has improved, the convergence of inflation to the target in the policy horizon requires that monetary policy remain highly expansionary. Thus, the MPR will be held at its 0.5% minimum until the recovery of the economy takes hold and spreads to the more lagging components of expenditure, which will take several quarters. The Board reiterates that future changes in monetary policy will depend on the evolution of the macroeconomic outlook and its implications for the evolution of inflation. The unconventional measures will continue to operate under the same conditions in place, complementing the monetary policy stance defined by the MPR. Any future modifications will be announced with sufficient notice.

SUMMARY OF FORECASTS

	2021 (f)	2022 (f)	2023 (f)
GDP (annual change, %)	6.0-7.0	3.0-4.0	2.5-3.5
Current account (% of GDP)	-0.9	-1.6	-2.4
Average CPI (annual change, %)	3.4	2.9	3.0
Average core CPI (annual change, %)	3.0	2.8	3.0
CPI in around 2 years (%) (*)	-	-	3.0
World growth (%)	6.2	4.4	3.5
Copper price (US$ cent/pound)	395	375	355

(*) Inflation forecast for the first quarter of 2023.
(f) Forecast.

Source: Central Bank of Chile.

BOX:

Improvements in monetary policy communication and transparency

The communication of monetary policy plays a key role in its transmission, especially in central banks that, as is the case of the CBCh, are autonomous and follow an inflation targeting scheme. This implies that central banks act in a predictable manner, and it is essential that they inform the public and the relevant market players about its diagnosis of the state of the economy, as well as the way in which monetary policy reacts at different junctures. For this reason, over the years, the Bank's Board has been increasing and improving the channels of communication it has with the public. Thus, for example, in 2009, it increased the number of MP Reports from three to four per year. Subsequently, in 2017 it increased the length of the press release associated with monetary policy meetings to explain in greater detail the rationale behind the decisions taken and has just recently published a book with the macroeconomic models used in its analyses and projections. As part of this continuous process of improvement, the Board has decided to introduce new forms of communication with the aim of reaching a greater number of people and, in fact, the aforementioned book of models was disseminated to a wider range of audiences. This box highlights the importance of communication in formulating monetary policy and reports on the improvements implemented as from this MP Report.

The importance of communication of monetary policy stems primarily from the CBCh's responsibility to inform as an autonomous entity. This entails giving an account of both its actions and compliance with its objectives. In addition, the effectiveness of monetary policy depends largely on whether the actions taken are understood by the people[1]/. Specifically, most of the monetary policy's transmission to the economy is produced by the public's perception of how it would adjust in the face of new information modifying the evaluation of activity, employment and inflation.

So far, the improvements that the Bank has made in communicating monetary policy have been mainly focused on the public more specialized in economic matters. However, several studies, including those presented at the XXIII Annual Conference of the Central Bank of Chile on independence, credibility and communication in central banking, have stressed the importance for central banks of opening channels of communication with the general public, that will also go beyond the traditional communication instruments[2]/. In particular, participants highlighted the challenge faced by monetary authorities in developing and communicating messages in a simple way, so that they can reach wider audiences, but without reducing the complexity and strength of the arguments behind them.

During 2019, the Board of the Central Bank commissioned an assessment of the fulfillment of its price stability and financial stability objectives to an Independent Evaluation Panel. The panel recommended improving the accessibility of the MP Report by reducing the degree of difficulty to read it, especially the summary. It also recommended expanding monetary-policy-related messages on social media, including quick and accessible explanations of the decisions on the monetary policy interest rate.

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[1]/ See "Central Bank of Chile: Monetary Policy in an Inflation-Targeting Framework."

[2]/ The forthcoming book "Independence, Credibility and Communication of Central Banking," edited by Ernesto Pastén and Ricardo Reis, includes the studies presented at said Conference.

These elements justify the improvements introduced as of this MP Report, which include a change in the website section of the Report, so as to centralize and facilitate access to all the information related to the MP Report. To improve the accessibility of the MP Report summary, an html5 format was included, making it easier to read from cell phones without the need to download files. In addition, products were added designed to deliver the main messages of the Report in a simpler way and for a more diverse audience, not specialized in economic matters: an explanatory video of the main messages and the document called "What this MP Report tells us", which uses illustrations and less technical language to explain it and is also disseminated through social networks. An FAQ section about the MP Report and the main topics covered in each issue is also part of the set of new products.

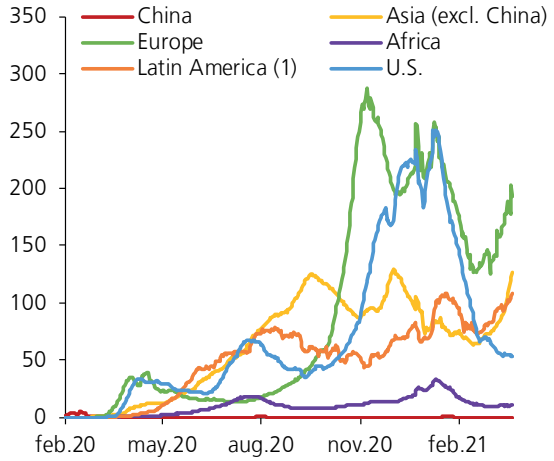
I. INTERNATIONAL SCENARIO

External momentum has increased thanks to a faster recovery of trading partners and higher commodity prices, particularly copper. The world economy has shown a better adaptation to the pandemic and, despite successive waves of infection, the general functioning of the economy has not been affected in the same way. As a result, much of the activity levels lost last year has already been recovered. However, the process still shows differences across sectors and countries, where those that have succeeded in better controlling the pandemic and/or the impact on their economies stand out. The improved outlook for this year combines the progress of the vaccination process with the announcements of substantial fiscal support measures, especially in the United States, and the continuation of the significant monetary stimulus. These factors could exacerbate the differences in the recovery processes. The improved global outlook has been reflected in the financial markets, with increases in long-term interest rates, stock markets and commodity prices. In this context, Latin America lags behind significantly, due to slow vaccination processes (Mexico and Colombia), difficulties to undo the deep falls of 2020 (Argentina and Peru) or the limitations to sustain stimulus policies (Brazil), all of which has been endorsed by the financial markets. Exiting this unusual crisis is not risk free, where worth noting are the implications of the significant mix of fiscal and monetary stimulus, which must ensure that it does not cause macroeconomic imbalances while ensuring the process of recovery. Any missteps in this area could lead to a tightening of financial conditions affecting emerging economies, especially the most vulnerable. In this scenario, special attention will be paid to the evolution of inflationary expectations in the US, while questions about the evolution of the pandemic will persist as a source of uncertainty for some time to come.

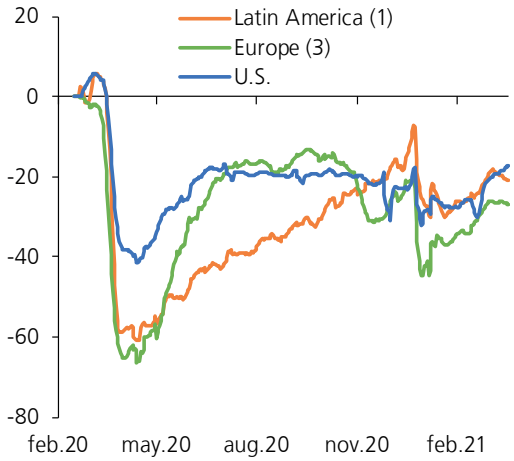
RECENT EVOLUTION OF THE INTERNATIONAL SCENARIO

Although in the first quarter infections resumed or exceeded the peak levels of 2020, the performance of the world economy was less affected than at the beginning of the pandemic (figures I.1 and I.2). China has continued to lead global growth, which has continued to boost the exports of its main trading partners and commodity prices. Short-term indicators —such as manufacturing output and retail sales— showed a milder impact of the outbreaks in the different economies and continued to drive world trade in goods, evidencing a better adaptation to continue operating in pandemic conditions. However, services that require greater human interaction have not recovered their pre-pandemic levels and continue to perform worse than other economic sectors.

FIGURE I.1 DAILY NEW COVID-19 CASES
(thousands, seven-day moving average)

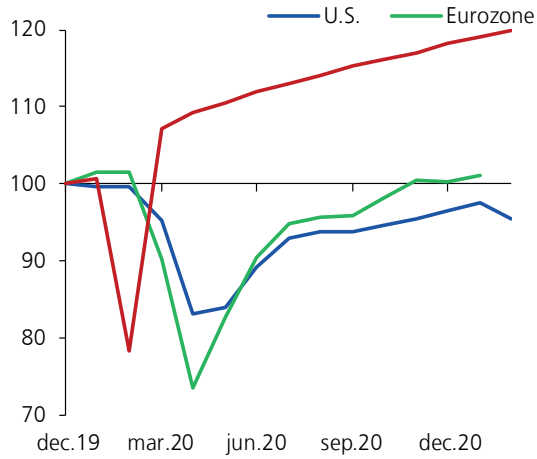


MOBILITY (2)
(seven-day moving average)

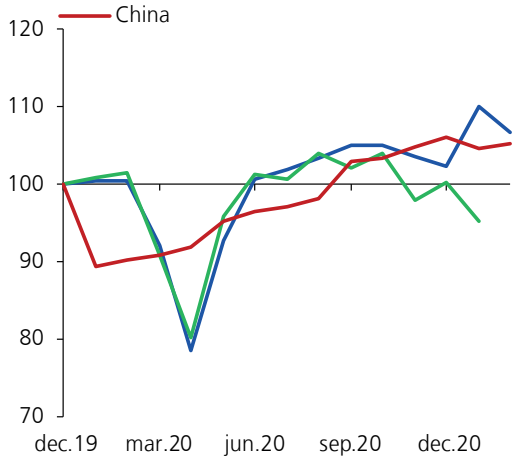


(1) Includes Argentina, Brazil, Chile, Colombia, Mexico, and Peru. Mobility considers the simple average of the same group of countries. (2) Simple average of categories retail and recreation, grocery and pharmacy, transit stations, and workplaces. (3) Simple average of Germany, Spain, France, Italy, and the U.K.
Sources: Our World in Data and Community Mobility Report - Covid-19, Google.

FIGURE I.2 MANUFACTURING PRODUCTION (1)
(index, Dec.19=100)



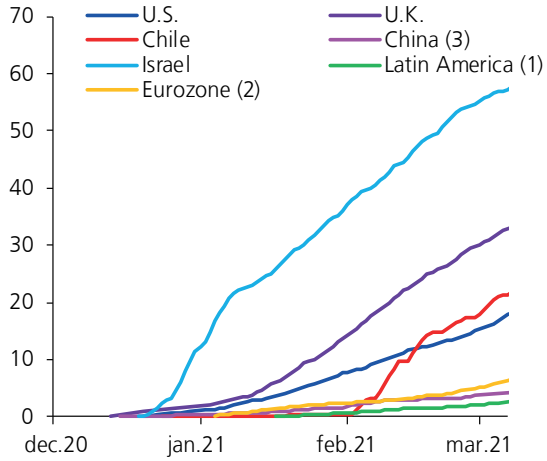
RETAIL SALES (2)
(index, Dec.19=100)



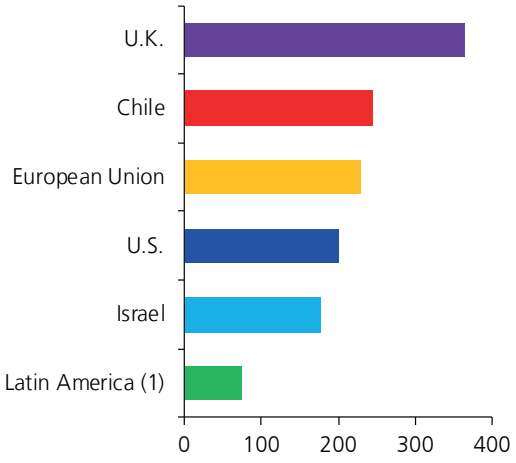
(1) Seasonally-adjusted real series. (2) Seasonally-adjusted nominal series.
Sources: Bloomberg y Eurostat.

Vaccine availability has made significant progress in recent months, as has the willingness of the population to be inoculated. However, the vaccination process goes at very different paces among countries (figure I.3), disputes have arisen between some of them, and problems have been observed in the production process that could hinder distribution. Although progress has been made with new vaccines, the possibility of accessing them is still low in many countries, especially in lower-income economies, and there has been negative news regarding compliance with production schedules, which adds to the institutional challenge of rapidly developing and implementing vaccination plans.

FIGURE I.3 ADVANCES IN VACCINATION PROCESS
(percent of population)



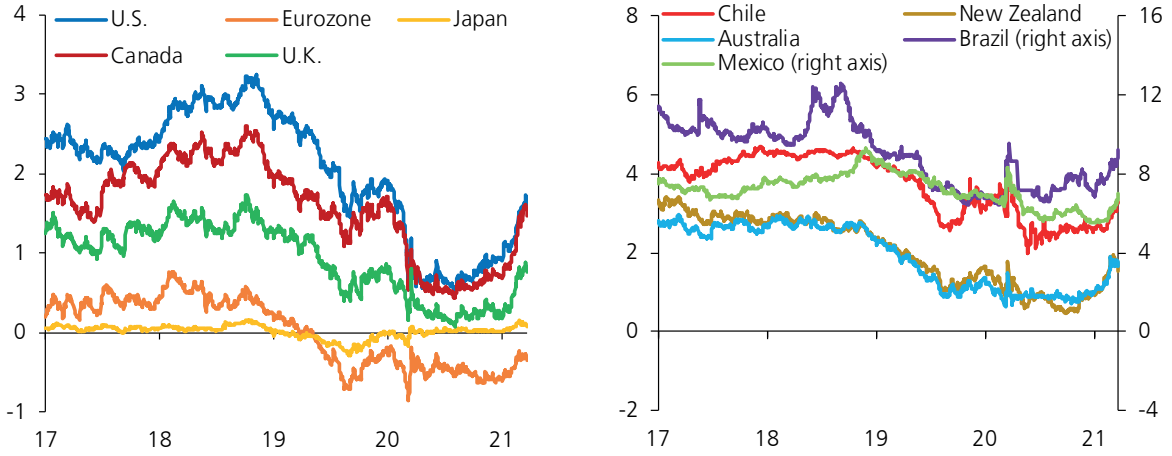
VACCINE CONTRACTS (4)
(percent of population)



(1) Weighted average by population for Argentina, Brazil, Colombia, Mexico y Peru. (2) Weighted average by population for Germany, Spain, France, and Italy. (3) Total jabs administered, whether first or second. (4) Population that can be vaccinated based on quantity of jabs required by each vaccine brand the countries have confirmed supply contracts.
Sources: Our World in Data and Duke Global Health Innovation Center.

The evolution of international financial markets has reflected the improved outlook for world growth, the progress of vaccinations, high monetary expansion and new fiscal stimulus packages announced, especially in the U.S. In this context, interest rates on sovereign bonds have risen in various economies, although they remain close their all-time lows (figure I.4). This increase has been amplified after the approval of new fiscal aid packages in some economies, such as the United Kingdom, Japan, and especially the U.S. In fact, the latter also saw an increase in real rates and breakeven inflation, although they remain low in historical terms. In view of this scenario, the monetary authorities in most economies have made no big changes to their forward guidance, with the prospect of maintaining policy rates at their technical minimums. Stock markets rose across the board, while currencies showed mixed performances. Risk premiums have decreased in several countries, with the exception of some in Latin America —such as Brazil and Peru —, and capital outflows have also been observed in recent weeks, despite the significant increase in commodity prices. This has occurred in a context in which the vaccination process has presented difficulties in the region and debt levels —both fiscal and corporate— have increased.

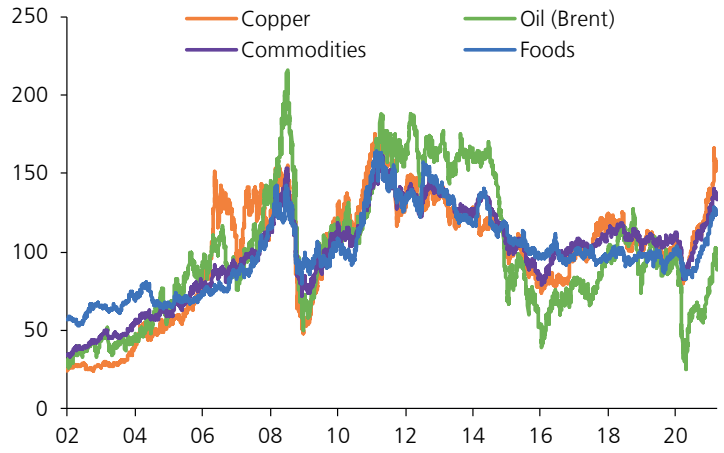
FIGURE I.4 10-YEAR SOVEREIGN BOND RATES
(percent)



Source: Bloomberg.

Commodities saw significant and widespread price increases, also in response to the improved international outlook, high global liquidity, and possible changes in their short- and medium-term fundamentals (figure I.5). Copper has been above US$4 per pound (+23% since December), due to stronger demand from China, increased industrial production worldwide, the y-o-y contraction of supply for the first time in almost twenty years, and the low levels of stock market inventories. However, these factors are expected to lose strength going forward, reducing the pressure on its price. Accordingly, an average price of US$3.75 per pound is forecast for the 2021-2023 period. In any case, part of the increase could be linked to the consolidation of prospects for higher consumption in the medium term, given the commitments to adopt green technologies, which could keep prices high for a longer period (Box I.1). In the case of oil, its increase has responded to the fact that OPEC+ has maintained its production quotas and to the adverse weather conditions in part of the U.S. In addition, the prospects of higher demand following the start and progress of the inoculation process, although the new restrictions recently announced in Europe have partially lowered this outlook. The average price of a barrel of oil (Brent-WTI) is around US$64 at the close of this MP Report (+42% since December), with values close to US$59 foreseen for the 2021-2023 period. In foodstuffs, the rise in cereals and oils stands out, combining supply-side factors —drought in some countries, supply problems and labor availability— with higher demand, particularly from China.

FIGURE I.5 COMMODITY PRICES
(index, 2002-2021 average = 100)

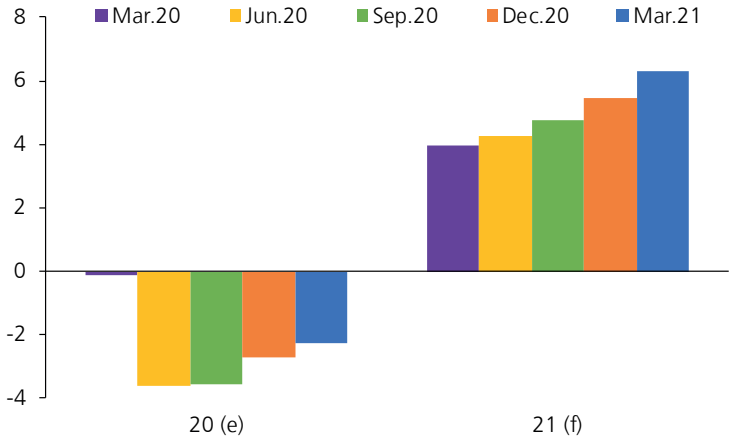


Source: Bloomberg.

PROSPECTS AND RISK SCENARIOS

The improved external scenario translates into higher growth forecast for our trading partners in 2021 and an improvement in the terms of trade. This revision takes into account the positive surprises in fourth-quarter 2020 figures in some economies, the dynamism sustained by China and the gradual recovery of global demand this year. Most of the upward adjustment in the growth projection comes from the effect of the new fiscal stimulus packages and their impact on global growth, particularly those announced in the UK, Japan and the US. The latter stands out, as it considers an increase in spending close to US$1.9 trillion (around 9% of 2020 GDP, accumulating over 25% since the beginning of the pandemic). This would imply a significant boost to growth through direct transfers to individuals and local governments, unemployment benefits, increased spending on health and vaccines, among others. This would be amplified by the expected increase in consumption, as the progress of the inoculation process allows easing sanitary restrictions, reversing part of the precautionary savings and/or contained spending by individuals. The revised projection also reflects the higher effective figures in Asia, mainly due to its integration with Chinese value chains, an auspicious outlook on the sanitary front and the greater fiscal impulse in some economies, especially India. Figures in the Eurozone and Latin America also exceeded expectations, although a slowdown is expected due to prolonged sanitary restrictions and slower vaccination processes. The combination of these elements explains why the growth of trading partners has contracted less than expected in 2020 and the upward revision of the projection for 2021 —to 6.3% y-o-y (5.5% in December)—, while for 2022 it remains at 4.2% per year. An expansion of 3.5% per year is forecast for 2023 (figure I.6).

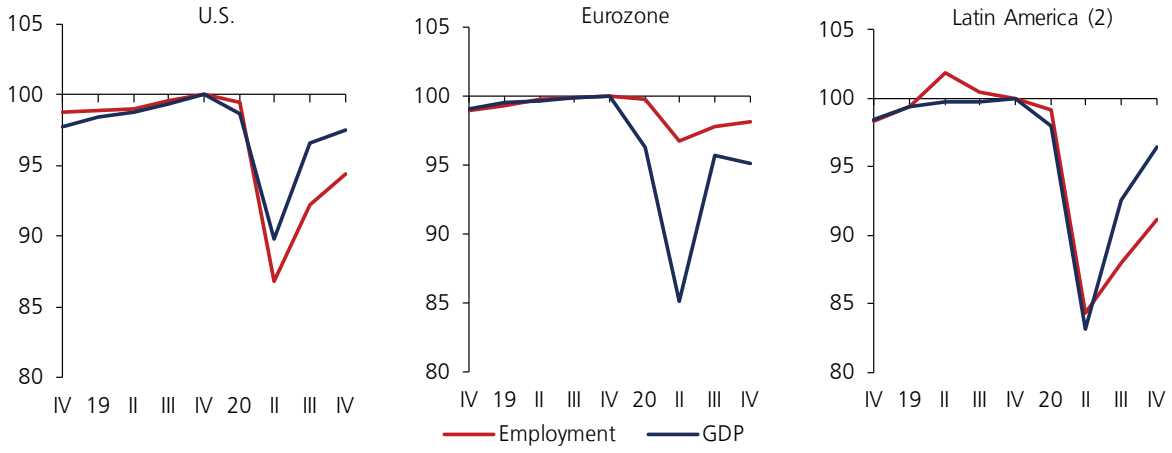
FIGURE I.6 TRADING PARTNERS: GROWTH FORECASTS IN LATEST MP REPORTS
(annual change, percent)



(e) Estimate. (f) Forecast.
Source: Central Bank of Chile.

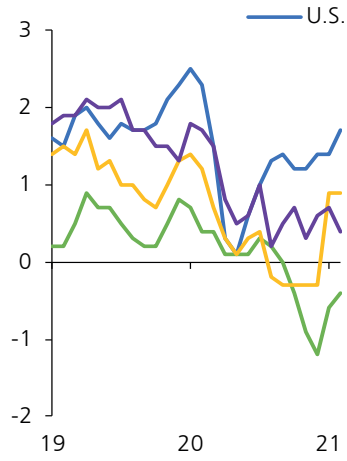
Inflation remains contained in the developed world and with expectations in line with their targets. In these economies, one-off increases linked to higher commodity prices, as well as to tax and methodological changes in the Eurozone, stood out. This, in a context in which core measures are still low and important gaps remain to be closed in the labor market of several countries (figure I.7). Inflation expectations point to a transitory increase in the short term, reflecting the rise in commodity prices, the lower comparison base left by last year and the announced new fiscal stimulus measures. Into the medium term, they remain below the target in the Eurozone and anchored to it in the U.S., despite the recent emergence of some concerns associated with the greater fiscal impulse (figure I.8).

FIGURE I.7 ACTIVITY AND EMPLOYMENT (1)
(index, IV.19=100, seasonally-adjusted series)

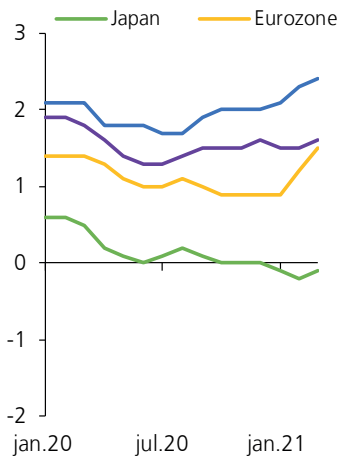


(1) Quarterly employment data for the Eurozone, and three-month average for the U.S. and Latin America. (2) The median for Brazil, Chile, Colombia, Mexico, and Peru.
Sources: Bloomberg and statistics offices of respective countries.

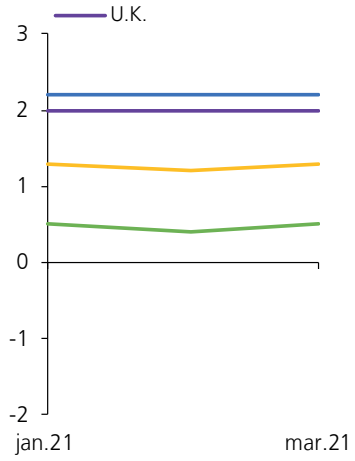
FIGURE I.8 HEADLINE INFLATION
(annual change, percent)



EXPECTATIONS FOR 2021
(year's average, percent)



EXPECTATIONS FOR 2022
(year's average, percent)



Sources: Bloomberg and Consensus Forecasts.

The process of exiting this crisis is not risk-free, especially due to the unusual nature of the shock, its magnitude and the set of measures implemented to confront it. The central projection scenario assumes that the world economy will see higher growth in 2021 and a moderation towards levels closer to its potential during the following two years. On the sanitary front, the epidemiological evolution is still uncertain, in view of new waves of contagion, new strains of the virus and the impact of the vaccination process. Nor can it be ruled out that this process will take longer, particularly in lower-income economies, due to difficulties in accessing vaccines, the emergence of conflicts between countries and the institutional challenges of implementing inoculation processes quickly. Poor performance on this front could increase uncertainty and risk aversion, deteriorating financial conditions. Another factor to monitor closely will be the withdrawal of the significant mix of fiscal and monetary stimulus, both in form and timing. Excessive or overly prolonged measures could lead to greater inflationary pressures and incubate potential risks to financial stability. In this sense, the latter could lead to a significant adjustment of inflationary expectations and the market could seek to anticipate the withdrawal of the high monetary stimulus, tightening global financial conditions, especially for the most vulnerable emerging economies due to their high indebtedness and/or with a depressed growth outlook for this and next year. This is particularly important in the midst of an equity situation at the corporate and government level that has felt the impacts of the pandemic, given the use of previous savings and/or increased borrowing. In contrast, a too early withdrawal of stimulus measures could be detrimental to the recovery process. In turn, the significant savings accumulated in some countries could translate into a faster recovery of global growth. Insofar as the increase in spending has a moderate impact on prices and financial conditions, it could translate into a greater external boost for the Chilean economy. Otherwise, it could also lead to inflationary pressures and a tightening of external financial conditions.

BOX I.1:

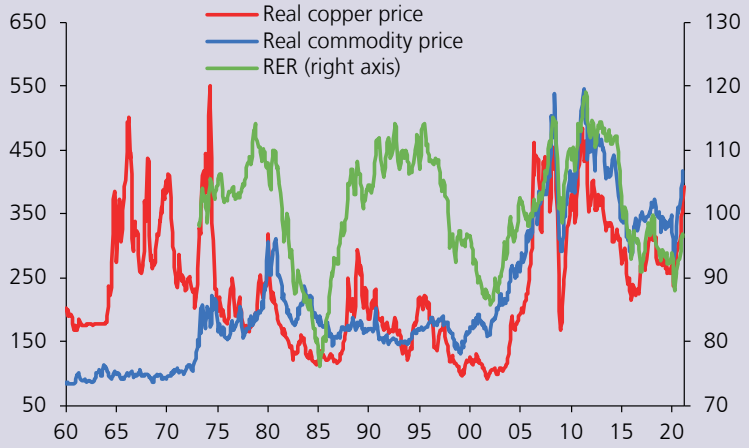
Copper price evolution and outlook

The price of copper has risen significantly, to values not seen since 2011. After the sharp drop at the beginning of the pandemic, the price almost doubled, surpassing US$4 per pound in recent months. The central scenario of this MP Report assumes that the copper price will fall slightly to an average of US$3.95 per pound in 2021. This trend will continue in 2022 and 2023, averaging US$3.75 and 3.55 per pound, respectively. This represents a significant upward correction from previous reports and considers that some of the factors that have pressured the price most recently will lose some traction. This Box reviews the behavior of the copper price from a historical perspective, the possible causes of the recent adjustment and scenarios for the coming years.

Historical evolution

In the last sixty years, two episodes known as the copper super-cycles stand out: the 1960s and the decade between 2003 and 2013. During these periods, the ten-year average price rose considerably with respect to the previous years. Both episodes were characterized by a strong increase in world demand for the metal, driven by high economic growth in Japan, the USA and Europe in the 1960s, and in China in the 2000s —following China's entry into the World Trade Organization—, the persistent and significant depreciation of the dollar, and the resulting generalized rise in commodity prices (figure I.9). During the 1960s, the demand for copper persistently grew above supply, while in the second episode the imbalance between demand and supply was smaller, but came hand in hand with a significant increase in production costs.

FIGURE I.9 PRICES OF COPPER AND OTHER COMMODITIES AND U.S. REAL EXCHANGE RATE (*)
(in 2020 dollars; inverse of March'73 RER level = 100)



(*) Copper and commodity prices deflated by the U.S. PPI.
Source: Central Bank of Chile based on Bloomberg, Cochilco and US Fed data.

In the same period, other episodes of significant increases in the price of copper were also identified, although they were more transitory. These coincided with the sharp oil price hikes of 1973 and 1979, and with the depreciation of the dollar in the late 1980s. In these episodes, the price of copper doubled, but after two or three years it had already returned to prior values.

Given the difficulty in anticipating the duration of the factors affecting the price, a common characteristic of these episodes is that the markets adjust their medium- and long-term price expectations only after several years of being at higher or lower levels. In fact, in the most recent super-cycle, analysts anticipated that the five-year price would be above US$1 per pound only when the price was persistently above US$3 per pound (figure I.10).

FIGURE I.10 REAL COPPER PRICE AND CRU GROUP PROJECTIONS (*)
(dollar cents per pound)

(*) Dashed lines show five-year forecasts at October each year.
Source: Central Bank of Chile based on CRU Group data.

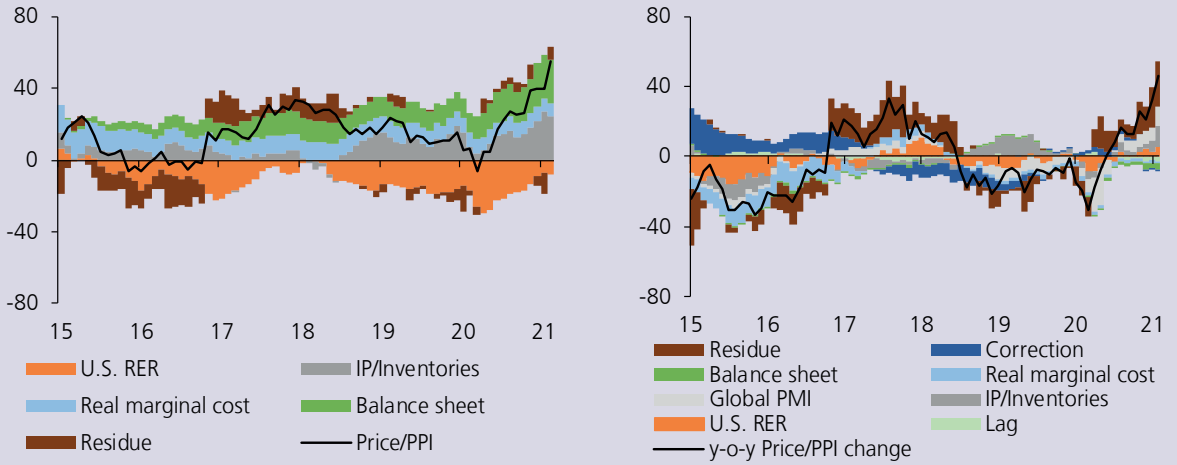
Recent developments

The rapid recovery of global demand coupled with the supply disruptions pushed up the copper price since the second half of 2020. The strong rebound in Chinese investment, global industrial production —supported by the relative bias of consumption towards durable goods—, and house construction in the US, boosted the recovery of global copper demand. At the same time, in addition to the usual downtime in mining production, there were stoppages at some mines for pandemic-related causes resulting in production falling for the first time in almost twenty years. Consequently, the balance sheet deteriorated over the course of the year, while inventories in the market dropped in January to lows not seen since 2004-2008, with a slight recovery since then. Low inventory levels not only generated greater price pressures, but are also associated with greater price volatility[1]/. These factors were compounded by the depreciation of the dollar and increased global liquidity, driven by expansionary conventional and unconventional monetary policies in developed economies, particularly the US.

[1]/ See Deaton *et al.* (1992).

The econometric models used at the Central Bank suggest that the aforementioned factors are behind the recent rise in the price of copper[2]/. However, both the increase and its current level are somewhat beyond what the historical relationship between the price and these fundamentals would suggest (figure I.11).

FIGURE I.11 ERROR CORRECTION MODEL: SHORT- AND LONG-TERM EQUATION (*)
(contributions, change from sample average (left) and from year before (right))



(*) Estimated for period Jan.1998-Feb.2021. Dependent variable: copper price deflated by U.S. PPI. Independent variables: U.S. RER, industrial production of various economies as a share of stock market inventories, global PMI, real marginal cost and median of balance sheet as a percentage of GDP of main international central banks.
Source: Central Bank of Chile.

Outlook

The factors driving the recent price increase are expected to lose some steam going forward. In addition to successful pandemic control, China's rapid recovery is based on the government's expansionary fiscal and monetary policies. While this is reminiscent of events following the Global Financial Crisis of 2008-2009, this time around the policies were somewhat less expansionary and, moreover, would be more transitory than then. The Chinese authorities have expressed concern about the economy's high level of indebtedness and announced a growth target that is marginally higher than the 2020 carry-over effect, making it clear that they are being cautious about how they expect the recovery to continue. Moreover, the government's intention to boost consumption rather than investment as the driver of growth would depress copper demand going forward. Moreover, supply would recover due to both fewer pandemic-related stoppages and new projects that would come on stream in the coming years. Finally, the recently announced fiscal package in the US could reverse the depreciation of the dollar observed over the last year, considering the good performance expected for the US relative to the rest of the economies.

[2]/ See López and Riquelme (2010).

Another factor determining the copper price outlook is the evolution of marginal production costs. Significant increases could support higher prices. However, unlike the last supercycle, marginal costs have fallen from their highs of 2013, settling in recent years around US$2.0-2.5 per pound. Although the supply's response capacity to bigger margins is not immediate, the current levels of production costs take some of the pressure off prices going forward.

In addition to the above, there are factors that, despite not necessarily having a fundamental role in explaining current demand or supply, could have a significant influence on its prospects. Most important among these factors in recent years has been the boost to demand that could come from the so-called "green wave". Governments' commitment to fight climate change, the consequent move towards renewable energies and the increased use of electric cars could have a material impact on the future demand for copper. Plus the expansion of 5G technology, which is also intensive in copper use. In this regard, the zero carbon announcements in China (Sep.20), the US presidential elections (Nov.20), the US rejoining the Paris Agreement (Jan.21), and the European Union's announcement to allocate 30% of the recovery budget to investment in climatic transition (Dec.20), point to the "green wave" having gained relevance compared to a year ago, and could also help to explain part of the recent price increase. In any case, estimates of the impact of these factors on copper demand contain a high degree of variability. In the most optimistic scenario, demand would expand significantly over the next decade, putting pressure on an uncertain response capacity of supply.

Conclusion

The recent rise in copper prices is explained by demand, supply and financial factors. Several of these are expected to lose strength in the near future, taking pressure off the price uptrend. Thus, the central scenario of this MP Report assumes that the copper price will decline over the projection horizon, to an average of US$3.75 per pound in 2020 and US$3.55 in 2023. However, it cannot be ruled out that in the coming decades the so-called "green wave" will drive the price for a longer time period.

II. FINANCIAL CONDITIONS

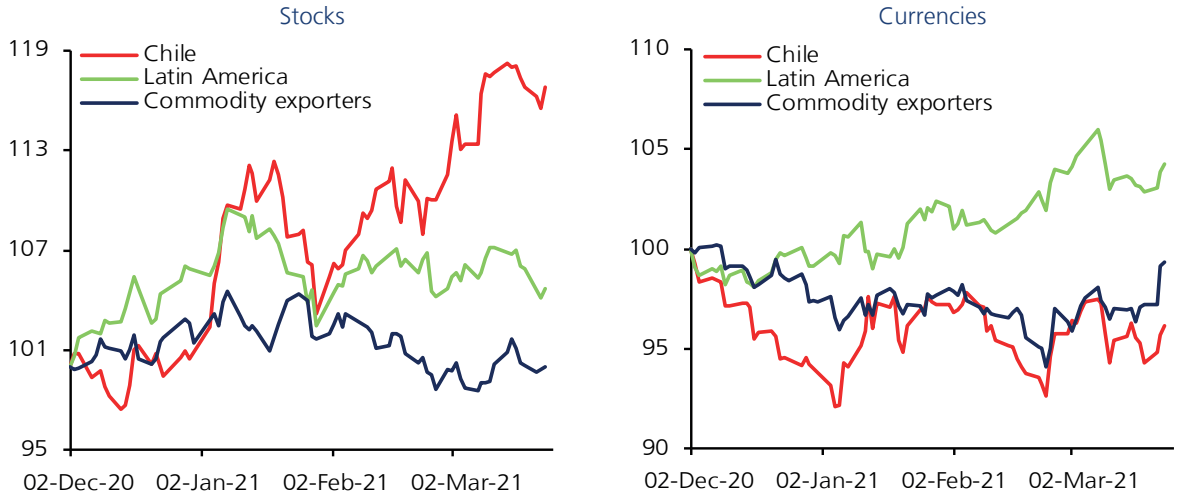
The external financial markets have benefited from the better records and outlook for world economic activity, which has been reflected in rising stock market indexes and sovereign bond interest rates. In any case, the latter continue at low levels, in a scenario in which monetary authorities around the world have confirmed an expansionary message. In Chile, financial developments have been in line with global trends. This couples with the significant increase in the copper price, which, together with other positive news at local level, have pushed the expected activity growth and the performance of the local markets in a more favorable position than is seen in other comparable economies, especially in Latin America. On aggregate, bank credit has lost dynamism, although with some recent rebound. The demand for commercial credit has shifted towards debt refinancing, as the pandemic drags on. To support this process, the government implemented a new program to extend the uses of Fogape (Fogape-Reactiva), which was complemented by the Central Bank with a third phase of the Credit Facility Conditional on Increased Lending (FCIC). In the bond market, spreads have been narrowing, although with issuance volumes below their historical figures. Even so, there are several latent risks that could affect financial conditions, mainly due to the deterioration of the net worth of companies, households and countries during the course of the pandemic, because of debt increases or asset downsizing. This adds to the global challenges in the management of stimulus policies.

EVOLUTION OF FINANCIAL MARKETS

International financial markets have performed positively, consistent with the rebound of the world economy and improved growth prospects. This has been supported by the better response to the pandemic, reflected in elements such as companies and households adapting to the current sanitary contingency, and the progress in vaccination processes, all in a context of highly expansionary monetary and fiscal policies. The latter has been particularly relevant in the United States, where a new stimulus package equivalent to 9% of 2020 GDP was announced in March. In last months, the U.S. economy has led the increase in nominal interest rates on longer-term sovereign bonds, in line with the rise in breakeven inflation and, more recently, in real interest rates. The rise in nominal yields has been replicated in the rest of the world with varying intensity and seasonality, although still low in historical terms across the board (figure I.4). The greater optimism has also permeated the stock markets, with renewed highs in several cases, as well as the commodities markets. Also, risk premiums have declined in a large group of countries, with exceptions mainly in Latin America (e.g., Brazil and Peru), where capitals have been outflowing in recent weeks. Currencies show mixed movements.

In Chile, financial markets have followed global trends, also motivated by the significant rise in the copper price, positive surprises in some short-term indicators and the rapid vaccination process, all elements that in turn have driven up market growth projections for this and next year. It should be noted that the performance of the Chilean markets diverges from that of its Latin American peers. The peso appreciated around 5% against the dollar since the December MP Report, in line with the strengthening in other commodity exporters. The IPSA accumulated gains of close to 19%, while sovereign (EMBI) and corporate (CEMBI) spreads fell further (figure II.1). At statistical cutoff, Chile's sovereign credit rating was downgraded by one of the world's main rating agencies, which did not have a major impact on the markets. In the rest of the region, factors such as difficulties in the vaccination process or high fiscal and corporate indebtedness have had a negative impact on the financial sector.

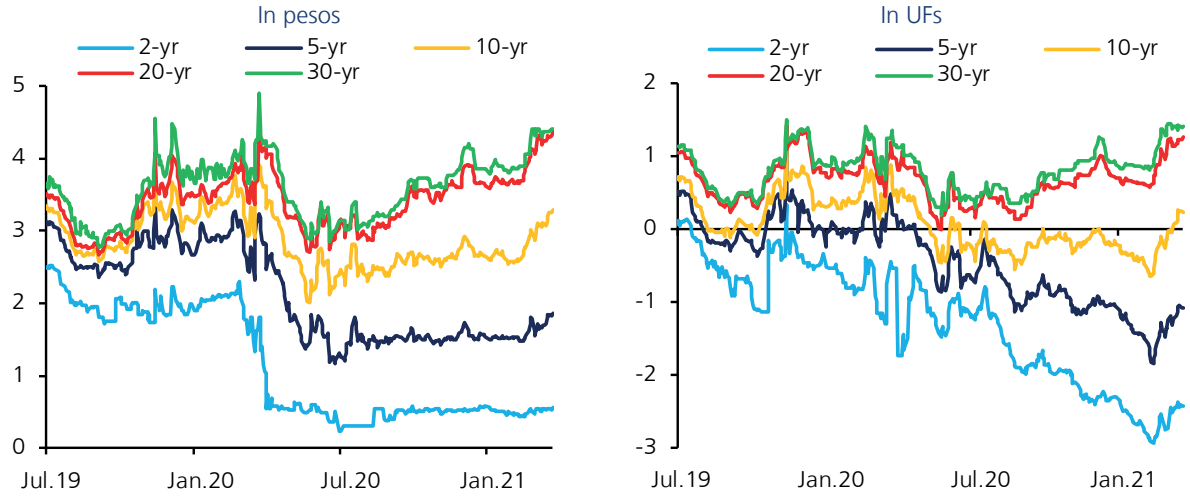
FIGURE II.1 FINANCIAL MARKETS IN CHILE AND OTHER COMPARABLE ECONOMIES (*)
(index, 2 December 2020 = 100)



(*) Simple average of respective indexes. Latin America considers Brazil, Colombia, Mexico, and Peru; commodity exporters are Australia and New Zealand.
Sources: Central Bank of Chile and Bloomberg.

As for benchmark bonds, yield curves steepened, as longer-term interest rates rose, influenced by the improvement in the local and external economic outlook. In any case, these rates are still low. On the nominal side, liquidity premiums (BTP-SPC) remain negative for terms of less than 10 years, largely related to the impact of the unconventional measures implemented by the Central Bank. The banks' demand for these instruments has been boosted thanks to their use as collateral within the framework of the FCIC. On the real curve, interest rates also rebounded in recent weeks, although those for terms of less than 10 years accumulated limited decreases with respect to December's statistical cutoff, affected by increased inflation expectations (figure II.2).

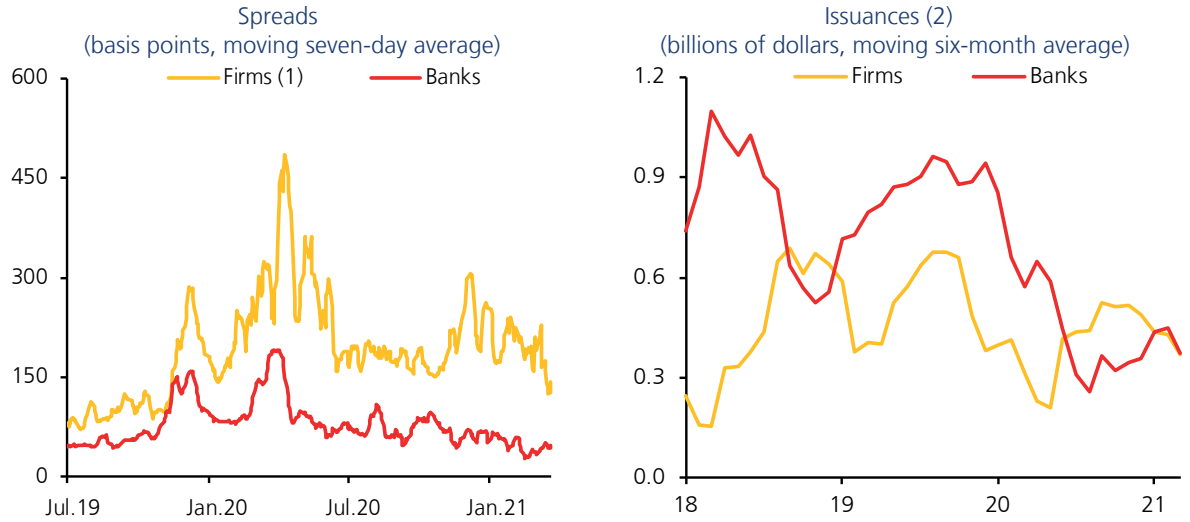
FIGURE II.2 BENCHMARK BONDS' INTEREST RATES
(percent)



Source: Central Bank of Chile.

Interest rates and spreads declined for corporate and bank bonds, with local issues accumulating several months of deceleration (figure II.3). In both cases, there has been greater interest from Mutual Funds this year to date. In the money market, the cost of financing in pesos remains at low levels, with rates in the secondary deposit market (DAP) below the MPR at different maturities. This, amid the banks' lower preference for DAP, given the more favorable funding conditions granted by the FCIC. The greater demand of Mutual Funds and Pension Funds for these instruments and for Central Bank's Discount Notes (PDBC) has contributed to the generalized decrease in money market rates. The cost of financing in dollars continues to be low, amid a rebound in the banking system's dollar-denominated liquidity in recent weeks.

FIGURE II.3 LOCAL BOND MARKET



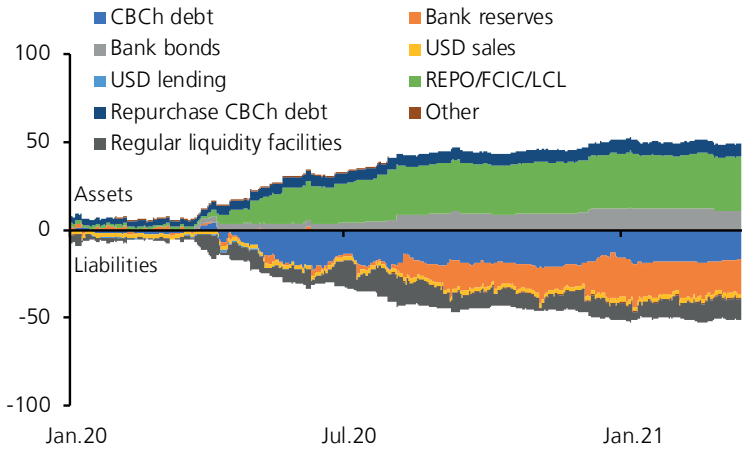
(1) Excludes risk categories BB or lower. (2) March 2021 considers data up to the statistical cutoff.
Source: Central Bank of Chile based on information from the Santiago Stock Exchange and the Financial Market Commission.

These developments occur in a context where the Board has kept the MPR at its technical minimum (0.5%) and has adapted non-conventional tools to the evolution of the ongoing contingency. In particular, a phase 3 of the FCIC was announced, with the purpose of adjusting it to the current financial needs of firms. This new phase complements the Fogape-Reactiva program, which aims to enable businesses to adequately renegotiate their obligations, finance new investment and access working capital, with an emphasis on the sectors most severely affected by the pandemic. FCIC3 expands the collateral eligible in its previous stages and provides for total resources of US$10 billion, equivalent to the remainder of FCIC1 and FCIC2. These first two phases ended with a utilization of around 95% and 30%, respectively, representing around US$30 billion on aggregate. In the days close to the statistical cutoff, the use of the FCIC3 amounted to around 15% of the available amount. If all three FCICs are fully implemented, the Central Bank will have provided liquidity to the economy equivalent to around 15% of GDP. This and other programs are part of a series of special measures that the Bank's Board has been implementing since late 2019, in order to smooth the proper functioning of financial markets. These include the purchase of bank bonds, the repurchase of Central Bank debt securities and REPO operations, the amounts of which have not changed in the margin.

In parallel, in the midst of a very significant external risk scenario, international financing lines have also been opened and/or extended with other counterparties, particularly with the Federal Reserve Bank of New York, the Central Bank of the People's Republic of China and the IMF. This is to strengthen Chile's financial position and provide flexibility in the administration of foreign currency resources. In January, a gradual program of replenishment and expansion of international reserves was added to ensure a proper transition once the credit line established with the IMF expires in 2022. This is being implemented gradually, with purchases of US$40 million daily over 15 months. This amount represents 3% of daily trading, thus ensuring a minimal impact on the liquidity of this market.

At the end of 2020, the set of exceptional measures implemented expanded the assets of the Central Bank's balance sheet by nearly 13 percentage points of GDP, largely through the FCIC and bank bond purchase programs (figure II.4). Liabilities also rose sharply, with a marked increase in banks' liquidity and PDBC. The increased issuance of the latter has played an active role in the withdrawal of excess liquidity resulting from the aforementioned exceptional adjustments.

FIGURE II.4 EXCEPTIONAL MEASURES IN CENTRAL BANK OF CHILE BALANCE SHEET
(billions of dollars)



Source: Central Bank of Chile.

Regarding monetary aggregates, it is worth noting the sharp increase in the growth of M1 and cash over the last year and a half, mainly due to increased demand for money because of the prevailing uncertainty and the exceptional access to typically illiquid funds (figure II.5). The Central Bank has accommodated this higher demand by expanding the money supply, understanding that the increase responds to the prevailing macroeconomic conditions and that it is necessary to maintain a highly expansionary monetary policy to ensure compliance with its objectives. Thus, between September 2019 and February 2021, the annual nominal growth of currency in circulation and M1 went from 5%-10%, to 60%-70%. This phenomenon has also been replicated in economies of the developed world.

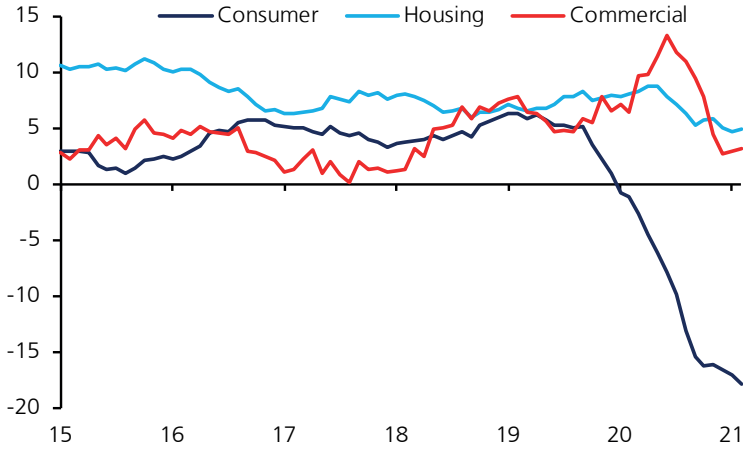
FIGURE II.5 NOMINAL MONETARY AGGREGATES, AVERAGE
(annual change, percent)

Source: Central Bank of Chile.

BANK CREDIT EVOLUTION

Commercial lending performance continues to show less dynamism compared to mid-2020, when it peaked due to the strong momentum of the Fogape-Covid lines. In any case, credit flows in this portfolio have seen a certain rebound in the margin, associated with the new Fogape-Reactiva program. The latter extended the uses of the first Fogape to the new needs that have arisen among firms, adding the funds granted for refinancing —including the Covid lines— and investment, all of which at the statistical cutoff had accumulated disbursements of nearly US$1.5 billion. A significant percentage of this amount had been earmarked for smaller firms and the trade sector. Fogape-Covid operations have been at their lowest for several months, while the rest of the new loans granted (non-Fogape) continue to show moderate activity. In this context, real annual growth in commercial credit was close to 3% between December and February. Lower figures could be observed in the coming months, given the high basis for comparison of mid-2020 (figure II.6).

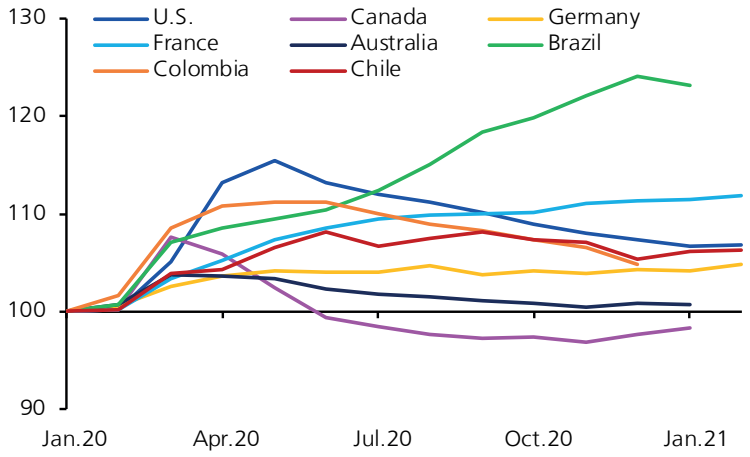
FIGURE II.6 REAL LOANS (*)
(annual change, percent)



(*) Real data constructed by splicing with CPI of 2018 annual base, at monthly frequency. Latest figure is February 2021.
Source: Central Bank of Chile based on information from the Financial Market Commission.

After the demand for credit initially responded to cover the firms' emergency financing, the slowdown in commercial loans in recent months is occurring in the midst of recovering earnings in some of them, and in which higher indebtedness could be limiting access to new credit in others. The latter is especially relevant in sectors intensive in social interaction, as confirmed by respondents to the February Business Perceptions Report (IPN). Also on a qualitative level, the fourth quarter Bank Lending Survey (BLS) reported tighter supply in this segment compared to the previous quarter, especially for SMEs, and weaker demand for both investment and working capital. This deceleration of commercial loans is also present in several countries (figure II.7).

FIGURE II.7 BANK CREDIT TO NON-FINANCIAL FIRMS
(index, January 2020 = 100)

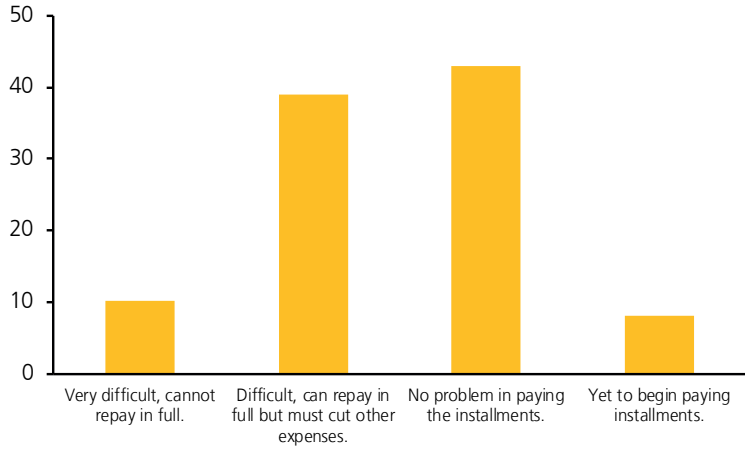


Sources: central banks of respective countries and Bloomberg.

On the households' side, there has been a sharp fall in consumer loans and moderate growth in housing credit. The former recorded a real annual contraction of 17.8% in February, and although they still maintain negative expansion rates, they have been gradually picking up. Meanwhile, mortgage loans increased by around 5% in real annual terms between December and February, with some increase in the average amounts per transaction in recent months.

With respect to the system's risk assessment, delinquency continues to be contained in the different segments. In the commercial portfolio, in particular, some indicators point to a quality deterioration. In the case of households, delinquency continues at its lowest of several years after a marked decline in the second half of 2020, mostly linked to the liquidity provided by pension fund withdrawals. Spending on provisions has remained stable in the housing segment, but has continued to increase in the consumer and commercial segments. Thus, within the latter, specifically in the commercial portfolio of individual evaluation —consisting of larger firms—, the increase in the share of non-performing or substandard categories stands out in its composition. Meanwhile, in February' s IPN, almost half of the firms surveyed that had active loans reported some or a great deal of difficulty in servicing their installments (figure II.8).

FIGURE II.8 BUSINESS PERCEPTIONS REPORT, FEBRUARY 2021
Today, how difficult is it for you firm to repay the installments of its financial obligations?
(percent of responses)



Source: Central Bank of Chile.

Interest rates remain at low levels for all credit categories, in line with the strong monetary impulse. In particular, in February they stood at 20% and 5.8% annually in pesos in the consumer and commercial segments, respectively (19% and 5.5% in November). For mortgage loans, the rate has remained at around 2.5% annually in UFs.

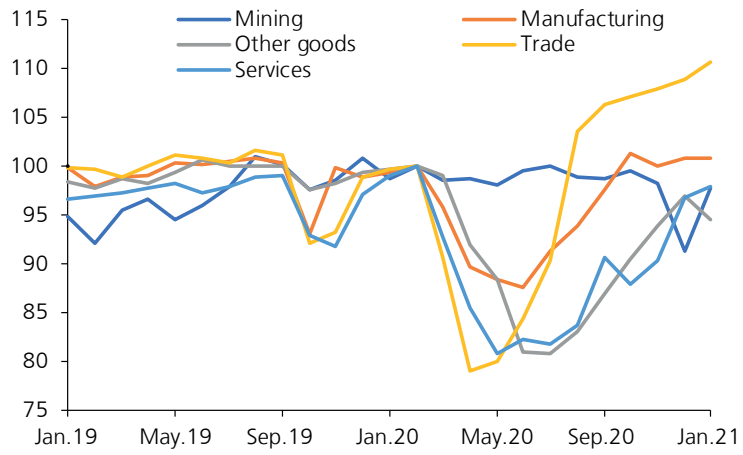
The global and local economies are undergoing a process of recovery that has had positive repercussions on the financial markets, but poses significant challenges. First, the future course of the pandemic is still uncertain, with vaccination progress being weighed against soaring infections and the emergence of new strains of the virus. Bad news on this front could increase uncertainty and risk aversion, thus worsening financial conditions. On the other hand, the authorities' regulatory, fiscal and monetary efforts have been substantial, and recent improvements in the economic outlook raise many questions about the future management of these policies. For example, the massive fiscal package in the U.S. could have a larger than anticipated effect on effective inflation numbers. To the extent that this leads to a significant correction of inflationary expectations and the markets' anticipation of the moment at which they expect the withdrawal of the monetary stimulus, global financial conditions could tighten, affecting particularly the most vulnerable economies and/or where growth prospects remain depressed. This is particularly relevant in the current context, where the financial situations of businesses, households and economies have been hit by the pandemic, given the higher indebtedness and/or lower savings incurred to mitigate the consequences. It could also happen that in some countries the fiscal impulse could be withdrawn prematurely, which would slow down the speed of recovery of global activity.

III. ACTIVITY AND DEMAND

The economy has continued to recover from the Covid-19 shock, despite persistent heterogeneity among sectors. Particularly relevant has been how firms and households have managed to adapt to operating under pandemic conditions, which has even led to higher-than-expected activity figures, in a context of very dynamic consumption —fueled by government aid and pension fund withdrawals— and a recovering global economy that has underpinned external demand. Investment, on the other hand, appears to be lagging behind. The GDP growth outlook for the year has improved, given the higher starting point left by activity in recent months, the better international scenario and a re-evaluation of the ultimate effects of the vaccination process. In any case, the economy will be affected by the setbacks in the Step-by-Step plan, most severely in March and April. Further ahead, the evolution of the labor market and the dynamism of investment will be important challenges for the full recovery of the economy.

The Chilean economy has continued to recover from the harsh disruptions caused by the pandemic, albeit with differences among sectors. In the fourth quarter 2020, GDP rose 6.8% with respect to the third, and has undone an important proportion of the decline recorded in the second. Worth noting is trade, the sector that has shown the strongest and earliest recovery. Manufacturing has also seen a significant upturn. Activities more dependent on human contact or where telecommuting is less viable continue to lag behind. One example of the latter is the poor performance of services and construction. Mining was largely spared during the peak months of the pandemic; however, its level of activity dropped in the second half of 2020, due to factors such as maintenance-related downtime and a drop in ore grades. The January Imacec (the only data for 2021 available at the statistical close) shows that the recovery trend has continued (figure III.1).

FIGURE III.1 IMACEC BY SECTOR
(seasonally-adjusted series; index, Feb.2020 = 100)

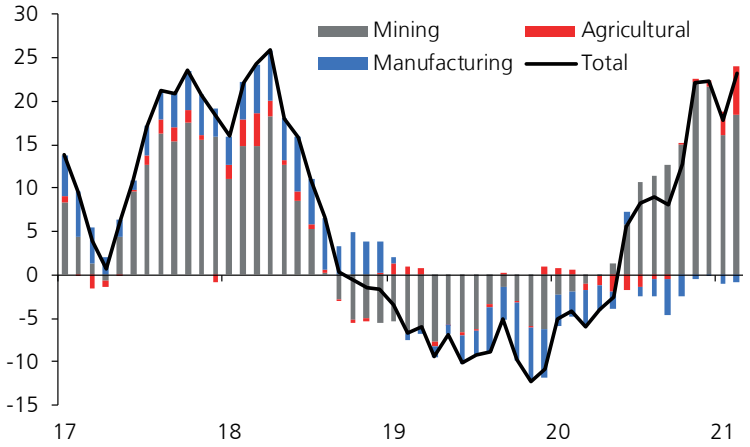


Source: Central Bank of Chile.

The recent evolution of activity suggests that the impact of sanitary constraints has moderated since the early days of the pandemic. Several elements have cooperated, including the changes to the constraints introduced with the adoption of the Step-by-Step Plan and its subsequent modifications, while businesses and households have learned to operate under such anomalous conditions. Thus, the relationship between the sanitary restrictions and activity —very strong early on in the pandemic— has changed since mid-2020; actually, the tightening of constraints decreed at the end of last year had a minor effect on the economy. These findings vary, however, at the level of macro-zones and economic sectors.

One factor that has had a positive impact on the economy's performance is the faster than anticipated improvement in the international outlook. The rapid rebound of China and other trading partners has strengthened demand for commodities, which together with the rise in global industrial production and low inventory levels in the stock market has driven the copper price above US$4 per pound, its highest since 2011 (Box I.1). Nominal exports of goods increased significantly in the second half of 2020, totaling more than US$73 billion and a growth of close to 7% annually with respect to 2019. This rebound was explained by higher prices and sales volumes. In January and February, this trend was favored by the increase in agricultural shipments (figure III.2).

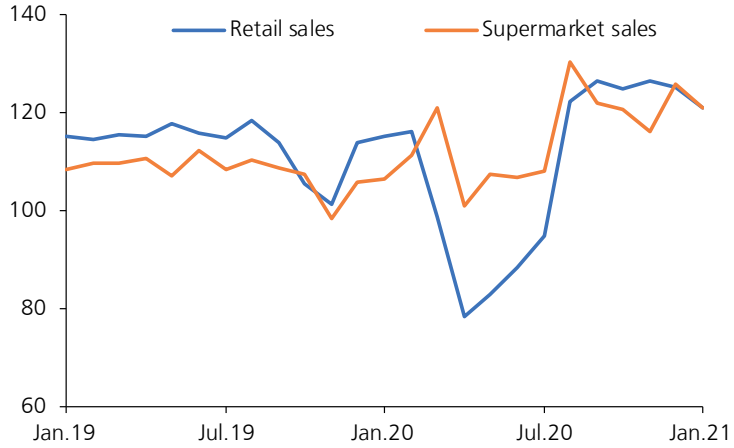
FIGURE III.2 NOMINAL EXPORTS OF GOODS
(contribution to annual change; moving three-month average, percent)



Source: Central Bank of Chile.

Household spending dynamics have been driven by supply-side constraints —especially in services— plus income support and liquidity measures. Private consumption fell sharply in the second quarter of 2020 due to sanitary restrictions, job losses and high uncertainty about the evolution of the pandemic. In the second half of the year, as restrictions eased and several income and liquidity support initiatives were implemented, private consumption rebounded significantly. Thus, after falling 22.3% annually in the second quarter and 9% in the third, in the last quarter of 2020 this expenditure component grew 4.1% annually. The withdrawal of part of the pension funds had a significant impact on this result, with higher sales volumes in retail trade (IACM), of both durables and non-durables, and in supermarket sales (ISUP) starting in August (figure III.3). The strong demand for some goods, such as automobiles and hardware products, combined with logistical problems in imports, has led to the depletion of inventories (February Business Perceptions Report; ANAC). All in all, consumption in 2020 was 6.8 percentage points below the previous year. This sharp drop was one factor behind the significant reversal of the current account balance from a deficit of almost 4% of GDP in 2019 to a 1.4% surplus in 2020 (Box III.2). The central scenario considers that a high level of consumption of goods will be maintained during 2021, explained by the fact that a considerable proportion of the liquidity generated by the partial withdrawals of pension funds has yet to be spent.

FIGURE III.3 RETAIL AND SUPERMARKET SALES (1) (2)
(seasonally-adjusted series; index, 2014 average = 100)



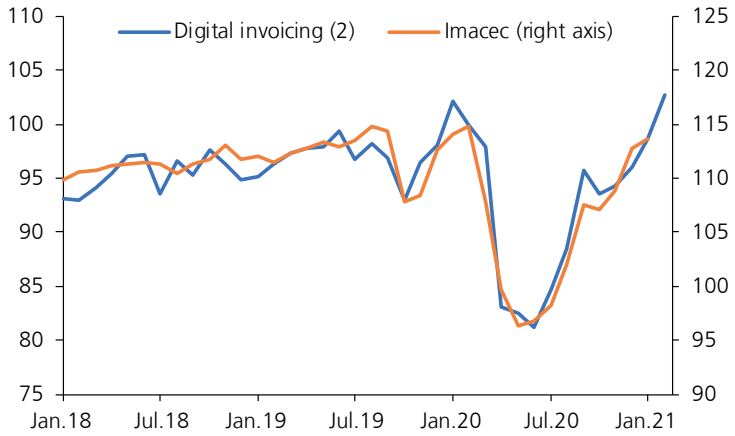
(1) Series at constant prices. (2) Retail sales measured by Retail Activity Index (IACM); supermarket sales measured by Supermarket Sales Index (ISUP).
Source: National Statistics Institute (INE).

The economic outlook for the year is favored by the better starting point left by activity between late 2020 and early 2021, the favorable international outlook and the positive evolution of the vaccination process. Last year closed with an annual GDP decline of 5.8%, which compares to the range of 5.75% to 6.25% decline forecast in December. Available first-quarter data, including January's Imacec and digital invoice sales, suggest that this improved performance of the economy continued at least into February (figure III.4). On the external front, the available data on activity and demand, the evolution of commodity prices and the performance of financial markets indicate that a better outlook for 2021 has been consolidating. The new cumulative evidence on vaccinations allows us to foresee that an advanced opening of the economy will be possible by the second half of the year. Furthermore, so far this year the government has announced new subsidies and transfers through adjustments to existing income support and labor market measures, including the announcements made during the closing week of this MP Report.

All of the above had translated into an improvement in expectations and an upward revision of growth projections for this year. Thus, data obtained prior to the relapse of the Step-by-Step Plan showed less pessimism on the part of consumers (IPEC) regarding their current and medium-term situation, as well as greater optimism on the part of firms (IMCE). At the same time, market expectations for growth in 2021 have improved. The Economic Expectations Survey (EES) for March anticipates growth of 5.3% this year (4.7% in December), but with high dispersion of responses (between 4.5% and 6.5% for the 10th and 90th percentiles), reflecting the current uncertainty about the future evolution of the economy.

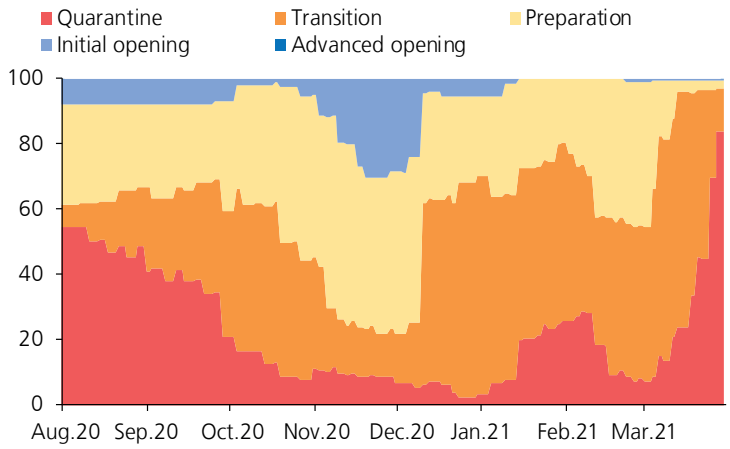
Nonetheless, the increased sanitary restrictions enacted during March will take a toll on the economy's recovery. The worsening of the sanitary situation in recent weeks and the reversals that have been adopted in the Step-by-Step plan lead us to anticipate an economic setback in the short term. At the statistical close of this MP Report, full confinement had been decreed for 84% of the national population (i.e., 24% above the worst period of 2020) and weekend quarantines for an additional 13% (figure III.5). The central scenario assumes that the biggest effect of these restrictions will be seen at the beginning of the second quarter, to then gradually fade away. In any case, this will be lower than at the beginning of the pandemic, as firms and households have learned to adapt to the new conditions, the restrictions themselves have been adapted -beyond more restrictive changes in the margin— and public policies already have a toolkit at their disposal to deal with the situation and deliver aid to the most affected.

FIGURE III.4 DIGITAL INVOICING AND IMACEC (1)
(index, Feb.20 = 100; index, 2013 average = 100)



(1) Seasonally-adjusted series. (2) Excludes mining, housing services, and public administration sectors.
Sources: Central Bank of Chile and Internal Revenue Service (SII).

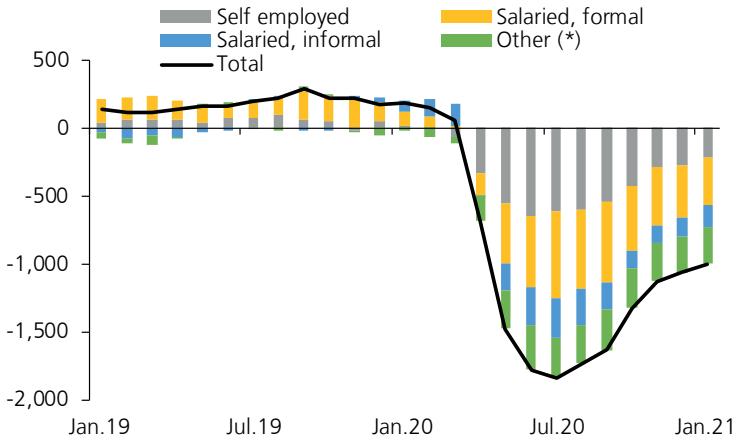
FIGURE III.5 STEP-BY-STEP PLAN: POPULATION IN EACH PHASE (*)
(percent)



(*) As of 30 March 2021.
Source: Chile's Health Ministry.

Beyond the immediate future, one factor that could put a brake on the speed of the economy is the performance of the labor market, which has not recovered with the same vigor as activity. Different sources of information point to employment advancing in the past few months, however, contrary to activity, its current level is still far from its pre-pandemic levels —nearly 1 million jobs lost according to INE data, although other sources indicate a somewhat lesser deterioration (figure III.6). In any case, it is noteworthy that both demand for and supply of employment have improved with respect to mid-year, with internet job postings increasing and inactivity decreasing. Regarding the latter, while Covid-19-related reasons have receded, inactivity remains high for women, many of whom had to quit their paid jobs to devote themselves to child and family care.

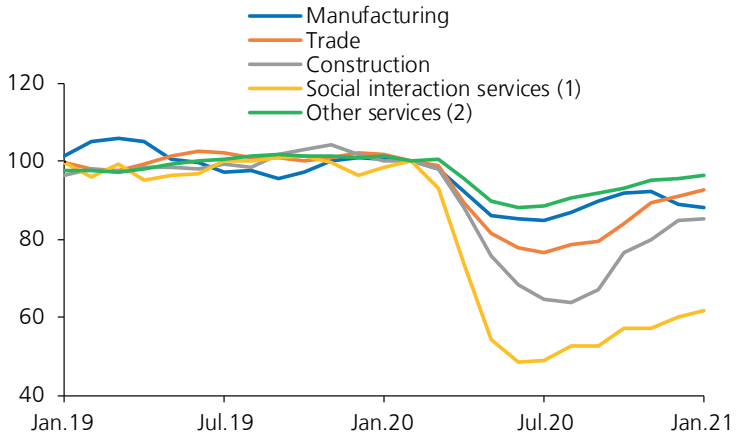
FIGURE III.6 EMPLOYMENT BY OCCUPATION CATEGORY
(y-o-y difference, thousand persons)



(*) Considers employers, household help, and non-remunerated family members.
Source: National Statistics Institute (INE).

By sector, the recovery of employment has been slower in services most intensive in human contact. Activities such as lodging, food services, arts, entertainment and recreation continue to be among the most affected (figure III.7). Interestingly, the trade sector, which has seen a significant rebound, does not report a recovery in the labor market in line with its activity levels. As of January, hours actually worked have recovered from their lowest in June, but are still somewhat below their pre-pandemic level (-2.5% with respect to January 2020).

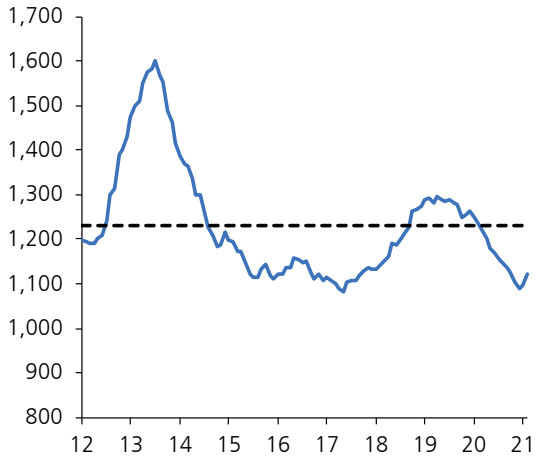
FIGURE III.7 EMPLOMENT BY SECTOR
(index, Feb.20 = 100)



(1) Includes lodging and food services; art, entertainment, and recreational activities. (2) Includes financial and insurance activities; real estates; professional, scientific and technical; administrative and support services; public administration and defense; teaching; human health and social care; other services; households as employers; organizations and extra-territorial entities.
Source: National Statistics Institute (INE).

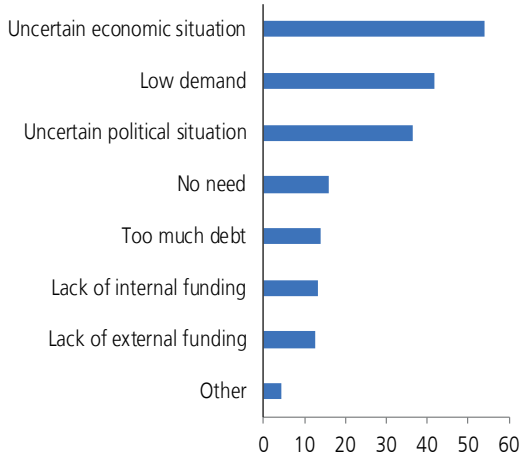
Investment is recovering at a much slower pace than consumption, affected by the high uncertainty regarding the course of the pandemic and the financial burden on companies. The low execution of public investment in 2020 stands out, affected by the sanitary conditions, as well as private investment in construction and works, in addition to the reallocation of expenditure to other fiscal measures. Anyway, in the fourth quarter, gross fixed capital formation reduced its annual contraction (-8.9%), mainly due to the better performance of the construction and works component. Regarding construction works, the December survey of the Capital Goods Corporation shows lower investment this year with respect to previous estimates, as mining and industrial plans have been rescheduled, and real estate projects have been abandoned. Meanwhile, the weakness shown by machinery and equipment is in line with the lower imports of capital goods during 2020. Although this trend has been reversing lately, its moving annual average is still below the levels of the last ten years (figure III.8). The information gathered in the February IPN shows that investments continue to be concentrated on the renewal of existing machinery and infrastructure and process automation. In addition, interviewees continue to respond that projects are affected by the uncertainty associated with the pandemic, the perception of insufficient demand, and the degree of indebtedness of their firms (figure III.9).

FIGURE III.8 CAPITAL GOODS IMPORTS (*)
(millions of dollars CIF, moving 12-month average)



(*) Horizontal dotted line shows last 10-year average.
Source: Central Bank of Chile.

FIGURE III.9 REASONS NOT TO INVEST IN 2021
(percent of responses)



Source: Business Perceptions Survey, February 2021.

The process of recovery of the national economy has consolidated gradually, so the outlook for this year has benefited from the better starting point left by the economy between end-2020 and the turn of 2021, the favorable international scenario and the positive development of the vaccination process. Overall, the unprecedented nature of the pandemic means that overcoming this episode will be confronted with many risks. At the moment, the imposition of stricter sanitary measures will affect the recovery process, which will resume only when conditions allow their withdrawal and the effects of the vaccination campaign become visible. Still, the epidemic's evolution remains uncertain, with new waves of infections, new strains of the virus and no clarity on how this could influence the sanitary measures. Furthermore, the recovery is heterogeneous, with some sectors more reliant on social interaction and employment that are the slowest in the reactivation process, which partly explains the gaps present in the labor market.

BOX III.1:

Impact of the sanitary restrictions and adaptation of the Chilean economy

The control of the pandemic has involved imposing voluntary and involuntary sanitary restrictions, which have had significant effects on the performance of activity over the last year. These measures have affected economic sectors with varying intensity: more severely on those more reliant on social interaction and/or located in communities with a more complex sanitary situation. As time has passed and people have learned to adapt, the restrictions have been fine-tuned while firms and households have adjusted to operate in the new scenario.

The adjustments to the Step-by-Step Plan, the better adaptation of firms and households, and the strong boost from consumption since the third quarter of 2020 meant that the restrictions' impact on the economy diminished as the months went by. As the data for late 2020 and early 2021 suggest, despite the setbacks in the Step-by-Step Plan enacted at the end of last year, activity managed to sustain the recovery process that had begun by mid-year. In fact, it performed better than expected and largely accounts for the upward revision of this year's growth outlook. Nevertheless, the recent tightening of restrictions is bad news for the economy, where the impact will be particularly visible in April. Its magnitude, in any case, will be smaller than what was seen 2020, thanks to the aforementioned adaptation and because public policies already have a toolkit specific for dealing with this situation and helping the most affected. This box documents the relationship between activity and sanitary restrictions, and describes their evolution in the different economic sectors.

A brief description of sanitary restrictions in the past year

The first cases of Covid-19 in Chile were identified in early March 2020. The disease spread rapidly, and by the middle of the month a series of measures to restrict travel and reduce social interaction had already been decreed. These included the suspension of school classes, the closure of restaurants, hotels and gyms, the closure of non-essential trade, and a massive shift to teleworking for those who could do their work in this way. By the end of March, quarantines began to be decreed in several districts of the country, and by the end of the second quarter, more than half of the national population was in total confinement, a figure that rose to 60% during July.

As the year progressed, the authority made modifications to the restrictions, establishing in July 2020 a plan called the "Step by Step Plan." This plan contemplates different restriction phases for each commune, ranging from the strictest (phase 1, or total quarantine) to the most open (phase 5, where all sectors may operate, although subject to sanitary protocols and with capacity restrictions in some cases). This allowed, under certain capacity conditions, the return of of activities highly dependent on social interaction, such as restaurants, hotels and gyms. Over time, the restrictions of each phase of the plan were also modified, allowing some sectors to operate even under quarantine. This measure was especially relevant for private construction. In recent weeks, in view of the sharp increase in the number of infections, some of these measures have been reversed.

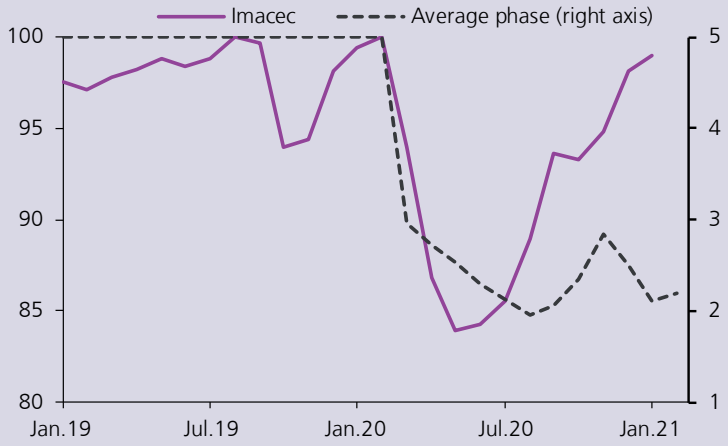
Adaptation of firms and households

The need to maintain social distance and comply with sanitary restrictions forced businesses and individuals to devise a number of adjustments to their day-to-day lives. Examples abound. The suspension of classes in mid-March led many schools to adapt their activities to be done online, a modality that they used for the rest of the year. The 2021 school year began at the same time for all schools, with a large number of them using a hybrid system combining online and face-to-face classes. E-commerce is another illustrative case. The pandemic has strongly boosted the online sales channel, including the development of technological platforms and distribution channels. Various studies show how the population's coverage and use of these services has increased[1]/. For some segments, however, adapting has been much more complex. Whether due to the type of work they do or the socioeconomic conditions of their families, there is a group of activities and people who have been unable to fully adapt to the conditions imposed by the pandemic.

The restrictions and economic activity

To analyze the relationship between the degree of sanitary restrictions and the evolution of activity, an indicator that reflects the average phase of the Step-by Step Plan in the country [2]/ and the behavior of the de-seasonalized Imacec are used as a reference (figure III.10). The data show that after the restrictions began in March 2020, increases in restrictions came in tandem with decreases in activity. This relationship broke down towards the middle of the year, when the Plan began operating and firms and households gradually began to adapt. In fact, the economic recovery began at the time of greatest restriction in 2020, and the changes enacted between December and January seem to have had a minor impact.

FIGURE III.10 POPULATION BY PHASE OF STEP-BY-STEP PLAN (NATIONWIDE) AND IMACEC
(seasonally-adjusted series; index, Feb.20 = 100; phase)



Source: Central Bank of Chile based on information from Chile's Health Ministry and National Statistics Institute (INE).

[1]/ This adaptation process is a phenomenon common to several economies. As highlighted by Bertinatto et al. (2020), the review of international evidence shows that during the first half of the year the fall in activity was sharper in countries with tighter restrictions and where precautionary behavior on the part of individuals was greater. These correlations, however, have gradually lost relevance over time.

[2]/ The phases are "Quarantine" (phase 1), "Transition" (phase 2), "Preparation" (phase 3), "Initial opening" (phase 4), and "Advanced opening" (phase 5). The time before March 2020 is homologated as "Advanced opening". For the period between March and July 2020, prior to the Step-by-Step Plan, only two phases are considered: "Quarantine", and "Preparation."

At the sectoral level[3]/ there is a general impact at the beginning of the pandemic, which changes in several sectors as from mid-2020, probably linked to the same factors mentioned above (figure III.11). In the case of trade, which posted a significant increase at the end of the third quarter, one must add the liquidity shock from the withdrawals of pension funds. In the case of construction, the upturn is more delayed because the ban on private construction operating in quarantine was only lifted late in the year. In any case, it is worth noting that there is a negative effect of greater restrictions on sales, which is particularly important when moving from phase 2 to phase 1 (see Briones et al., 2021). This result is relevant given the recently imposed restrictions.

FIGURE III.11 POPULATION BY PHASE OF STEP-BY-STEP PLAN (NATIONWIDE) AND REAL DIGITALLY-INVOICED SALES, BY ECONOMIC SECTOR (1)
(seasonally-adjusted series; index, Feb.20 = 100; phase)

(1) CPI-deflated sales. (2) Includes restaurants & hotels. Source: Central Bank of Chile based on information from Chile's Health Ministry, National Statistics Institute (INE), and Internal Revenue Service (SII).

[3]/ Briones et al. (2021) presents an econometric analysis that exploits the temporal and regional variation of the restrictions and aggregate and sectoral sales.

Briones et al. (2021) also present results at the geographic level, showing greater heterogeneity related to the time at which each macro-zone of the country experienced its respective peak of infections and restrictions during 2020. Thus, while the Metropolitan Region suffered the greatest restrictions between June and August, in the macro-zones[4]/ North and Center, this occurred around September and with new increases in early 2021. It should also be noted that in the South and Austral macro-zones, the recovery has been slower, which could be explained by a greater difficulty to adapt because of territorial factors, such as the higher costs of logistics and shipments in these farthermost zones.

Conclusion

The analysis of the relationship between sanitary restrictions and economic activity shows that their impact has diminished compared to the early days of the pandemic. This result combines the evolution of restrictions, the adaptation of firms and households, and the strong boost to consumption since the second half of 2020. Despite this, the recent setbacks in the Step-by-Step Plan are expected to have a negative impact on activity, as the effect of going back to the most restrictive phase (quarantine) is considerably higher than that of being in the next phase up. In any case, the impact will be more limited than that of 2020, for the same reasons of adaptation and because public policies now have a set of tools to aid the most affected. Certainly, the final scope of the impact will depend on how long the most restrictive phases will be kept in place, which will be subject to sanitary factors.

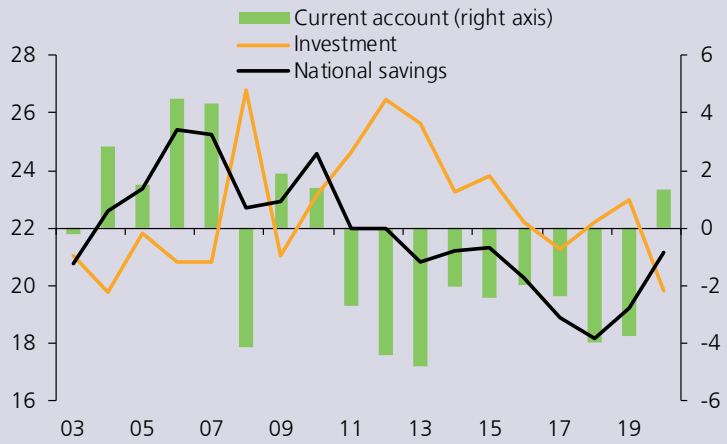
[4]/ The macrozones follow the definition of the Ministry of Science, Technology, Knowledge and Innovation (DS 7 of Law 21 105).

BOX III.2:

Current-account adjustment over the Covid-19 crisis

After almost a decade with negative balances, during 2020 Chile's current account recorded a surplus of US$3.37 billion, equivalent to 1.4% of GDP[1]/ (figure III.12). This strong correction with respect to the 3.7% of GDP deficit of 2019 is among the sharpest for emerging countries in this period. This Box examines the composition and specifics of this adjustment, showing that the increase in savings and the decrease in investment that led to the current account reversal were mostly related to: (i) mobility restrictions that affected consumption; (ii) precautionary behavior associated with the increased uncertainty and rapid deterioration of the labor market; (iii) households and firms facing significant liquidity constraints during the first months of the pandemic; and (iv) the significant increase in the copper price towards the end of 2020. There is no evidence linking the variation of the current account with external financing restrictions, a usual characteristic of this type of phenomena. From a comparative perspective, current account reversals during the Covid-19 crisis were less common in developed countries, probably because they faced it with a more extensive social safety net that helped a more rapid expansion of fiscal transfers, contributing to sustain higher levels of aggregate expenditure.

FIGURE III.12 NATIONAL SAVINGS AND INVESTMENT
(percent of GDP)



Source: Central Bank of Chile.

[1]/ At the end of 2019, a current-account reduction in its deficit was foreseen in 2020 —to near zero levels— based on the weak domestic demand that was assumed for the year (see Box V.2 in the December 2020 Monetary Policy Report).

Savings-Investment balance

The current account is equal to the difference between national savings and investment. National savings, on the other hand, equals the difference between gross national disposable income and consumption. Both savings and investment can be disaggregated between their private and public components. From this perspective, the increase in national savings responds mainly to an important increase in private sector savings and a fall in corporate investment, without an equivalent increase in the fiscal deficit (public savings minus public investment) (figures III.13 and III.14). This is explained by the fact that sanitary restrictions hindered both the consumption of goods and services and the development of investment projects, while the sharp increase in uncertainty drove households and firms to behave in a precautionary mannerTo this must be added the difficulties in accessing local financing and fiscal transfers early in the pandemic. This situation was reversed during the second half of the year, via credit programs for working capital[2]/, access to pension savings, and bonds and subsidies to households in the form of government transfers[3]/. Even so, private savings are estimated to have increased by around 6.5 percentage points (pp) of GDP between 2019 and 2020 (figure III.13), while non-mining private investment dropped by around 3pp of GDP in the same period (figure III.14).

FIGURE III.13 SAVINGS BY ECONOMIC AGENT (1)
(percent of GDP)

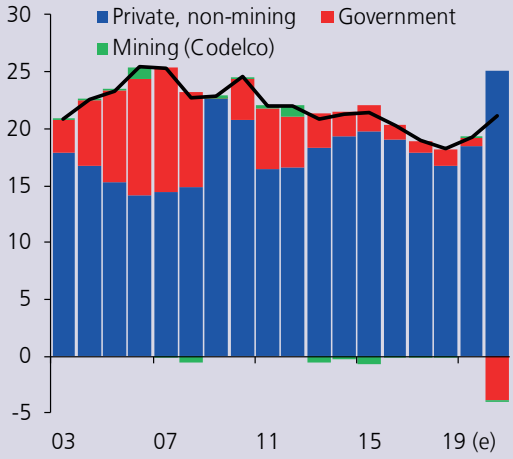
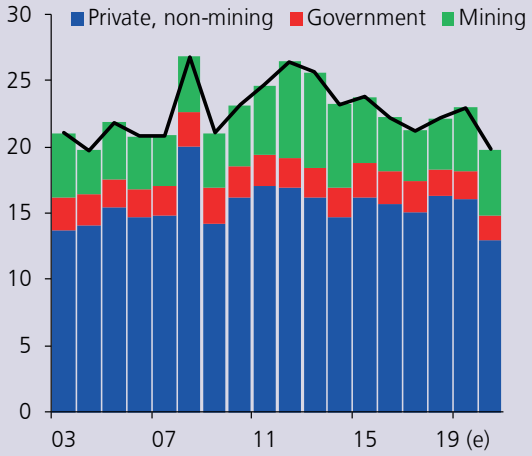


FIGURE III.14 INVESTMENT BY ECONOMIC AGENT (2)
(percent of GDP)



(1) Codelco figures use withheld income, calculated as the annual difference of cumulative income/loss based on its accounting statements. (2) Mining investment uses Mining GFCF. In annual terms, up to 2017 indicates information published in the investment matrix by economic activity. Estimations for 2018, 2019 and 2020 based on financial statements (plant and equipment).
(e) Estimate.
Source: Central Bank of Chile.

[2]/Income was also favored by government transfers and subsidies, and tax reductions.

[3]/ The partial withdrawals of pension funds are neutral to household savings because they only imply a change from an illiquid asset to a liquid one. If households motivated by this change in composition decide to consume more, then their savings decreases since their labor income and property rent net of taxes/transfers have not changed.

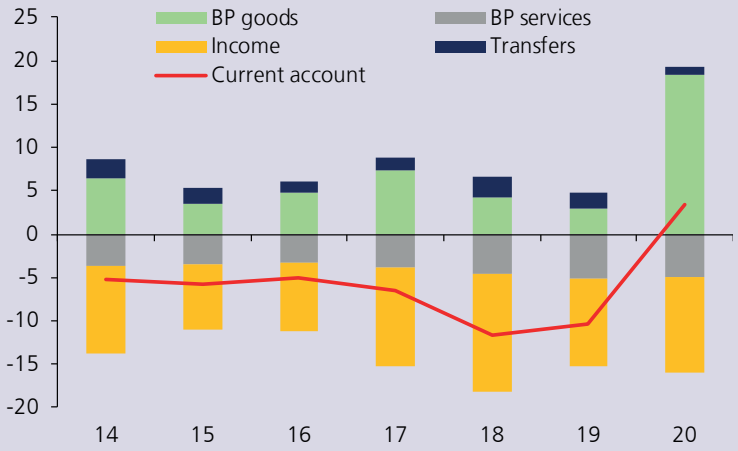
The public sector, on the other hand, increased its current spending by around 14.5% in real terms compared to 2019. In a context of lower revenues —despite the copper price improvement observed towards the end of the year—, this generated a drop in government savings from around 0.7% of GDP in 2019 to -3.9%% in 2020. However, given the magnitude of private savings growth and the limits imposed by the public sector's size in the economy, the fall in government savings brought about only partial compensation[4]/.

The trade balance and net payment to external factors

Regarding transactions with the rest of the world, the 2020 current account reflected primarily a surplus in the goods trade balance, marginally offset by the deficit associated with withheld earnings from foreign investment in Chile and the services trade balance (figure III.15).

Contrary to what was expected at the onset of the pandemic[5]/, world demand for exports of Chilean goods was not significantly affected. The copper industry faced several challenges throughout the year due to Covid-19 restrictions and infections inside facilities, but managed to maintain continuity and a volume of exports similar to last year's, benefiting from the higher prices. Industrial shipments, although down in value, increased in terms of volume, due to higher external demand for food products from China, the U.S. and Europe. This improved export performance helped to mitigate the steep drop in revenues observed in 2020.

FIGURE III.15 CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS
(billion dollars)



Source: Central Bank of Chile.

[4]/ The National Accounts by Institutional Sector (CNSI) for the fourth quarter of 2020 will be published next 19 April, along with revisions to previous figures. This will allow for a better understanding of the variations in savings and investment of the different agents. Third-quarter data show that private saving increased for both non-financial firms --driven by production income, reduced distributed income, and lower tax payments-- and households. Data for the fourth quarter are expected to show a decrease in household savings, reflecting the period's increase in consumption, funded by the partial withdrawals of pension savings.

[5]/ See the March 2020 Monetary Policy Report.

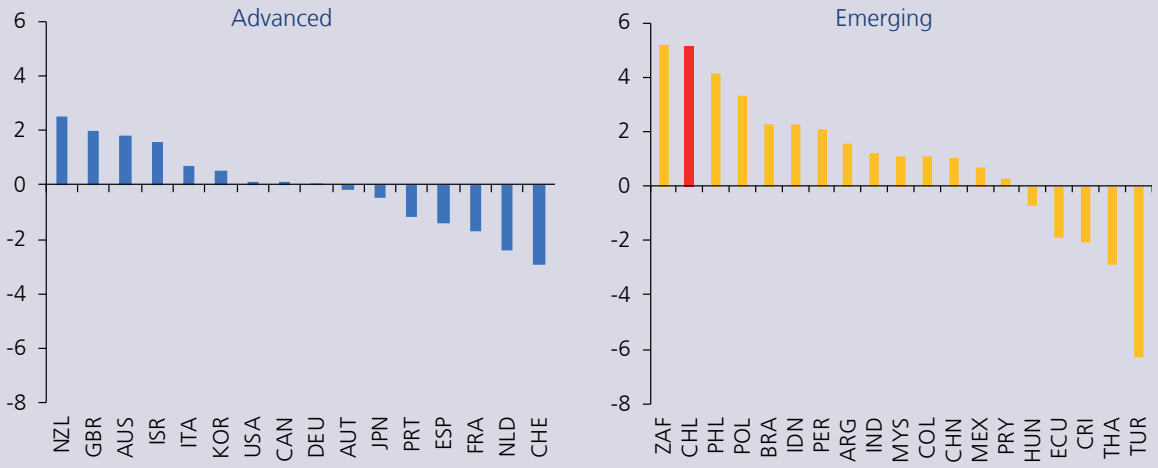
The copper price, meanwhile, evolved favorably during the course of the year, contrasting with other recessionary episodes. Thus, at the start of the pandemic, the price fell back from around US$2.7 per pound to closer to US$2.2. Then, as the global recovery took hold, the price began to escalate, and has recently reached around US$4 per pound.

In line with the aforementioned falls in consumption and investment, imports of durable and semi-durable consumer goods and energy products —particularly oil and diesel— were strongly affected by the restrictions on mobility and the greater uncertainty of households and firms. The fall in imports of capital goods and other intermediate goods was more moderate. This reaffirms the notion that the decline was due to uncertainty and lower mobility. The services trade balance[6]/ and net direct investment income remained at levels similar to those of the previous year.

International comparison

Within the international context, measured as a share of GDP, the reversal of the Chilean current account is among the largest. This, considering that such reversals were bigger and more frequent in emerging than in developed countries (figure III.16). There are multiple reasons that could explain the different degrees of adjustment in each country, including the intensity of the quarantines that hampered consumption and investment; access to local funding sources to soften the impact of lost income; the timing and intensity of fiscal transfers to the most affected households and firms; the relative weight of the sectors most affected by the sanitary restrictions; the composition of foreign trade; and the behavior of the terms of trade. Traditionally, access to external financing has been a crucial determinant of the external adjustment, but this time, as discussed in Chapter I, external financial conditions have remained very loose for most countries, largely due to the very expansionary monetary policies in the more developed economies.

FIGURE III.16 CHANGE IN CURRENT ACCOUNT 2019-2020
(percent of GDP)



Source: International Monetary Fund.

[6]/Exports and imports of services fell by similar proportions, mainly influenced by the travel components and, to a lesser extent, air transport services and operating rental of air crafts.

External financing

External financing evolved very differently with respect to balance of payments crises or sudden stops, such as, the global financial crisis. While in cases like this, restrictions on external credit paralyze local financial flows, forcing a significant adjustment in spending, in 2020 the adjustment responded to greater uncertainty, sanitary measures and constraints on domestic credit for certain groups. The financial account of the balance of payments shows, on the liabilities side, that foreign direct investment was similar to the 2017-2019 average and was due to capital contributions and reinvestment of profits, mainly made in the corporate sector. Although portfolio investment (equity and debt securities) was somewhat lower than its 2017-2019 average, it outpaced that of 2018, given both corporate and government bond issuances. Moreover, financial conditions were generally favorable, with countercyclical bank credit stock and low interest rates from a historical perspective. In addition, the real exchange rate (RER) appreciated during 2020, contrary to what is typical of sudden stop episodes.

At the end of 2020, the net international investment position (IIP)[7]/ decreased its debit balance, mainly due to the reduction in the banks' liability position as a result of loan repayments to non-residents. The stock of pension fund assets rose in value, given the good performance of international stock markets. This effect more than offset the amounts liquidated in international securities as a result of the withdrawal of pension funds. Assets abroad increased, reflecting investments in the non-financial corporate and household sectors. In contrast, the government saw a deterioration in its net position from the sale of assets abroad. It is worth noting that the errors and omissions account showed a relatively high level in 2020, which makes it difficult to figure out how the financial counterpart, at the level of economic agents, squares with the dynamics observed in the trade balance.

Conclusions

The recent evolution of the current account responds to the type of shock that the Chilean economy faced because of the pandemic. The significant increase in private savings more than offset the fall in government savings. This behavior is explained by the strong adjustment of consumption in the first half of the year, denoting a precautionary behavior, but also forced by supply restrictions and logistics, and possibly by restrictions on domestic financing due to the perception of higher credit risk. In any case, the adjustment differs greatly from a balance of payments crisis episode, with an appreciating real exchange rate and a reduction in the funding costs. The central scenario of this Report foresees a strong recovery of private consumption and a rebound of investment in all its components in 2021, resulting in the current account returning to a deficit, estimated at around 1% of GDP.

[7]/ The IIP is the general balance of the financial assets and liabilities of the economy compared to the rest of the world, and their difference between one period and another, it does not only correspond to the transactions (financial account) that occurred in the meantime, but also, to revaluations (price and exchange rate) and other variations.

IV. PRICES AND COSTS

Annual inflation continues to hover around 3%, but with significant month-to-month fluctuations, largely explained by the behavior of volatile prices and the impact of supply constraints in the face of a strongly increasing demand for certain goods. In the short term, these factors will continue to influence inflation dynamics, although with reduced intensity than in previous months, with annual inflation expected to increase temporarily to near 4% in the coming months. The evolution of fuel prices in the external market will play an important role in this behavior, as they have not only risen in recent months, but compare with a low comparison base in the mid-2020s. Meanwhile, core inflation is expected to face more limited pressures than in the previous months due to the effect of the exchange rate appreciation pass-through to goods and the impact of supply constraints on services, with core inflation expected to fall to 2.6% by the end of this year. In the medium term, inflationary pressures remain in line with the 3% target, and it is projected that the supply-side factors will gradually fade out, while the economy closes the capacity gaps of today.

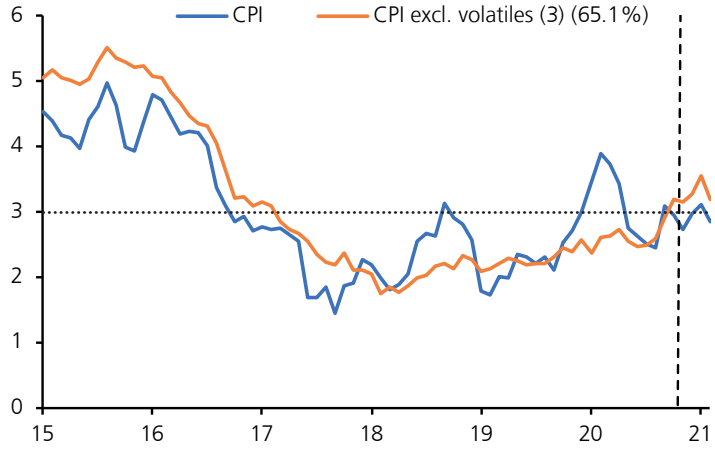
INFLATION'S RECENT EVOLUTION[1]/

Headline inflation has been around 3% in recent months, with higher than usual month-to-month variability in some items (figure IV.1). Between December and February, inflation accumulated an increase of 1.2 percentage points (pp), with more than half of this increase occurring in January (0.7pp), when total inflation was 3.1% annually. The cumulative contributions in this period show that inflation continued to be driven by the prices of goods. This coupled with greater contributions from energy and food, particularly fruits and vegetables in January. In contrast, services prices remained weak, with some of them not yet measurable because of pandemic restrictions. Compared to our December projections, total inflation was higher, explained by a higher-than-expected increase in the volatile component, especially for fuels and fruits and vegetables. Core inflation did not show major differences with respect to projections.

The considerable fluctuations in the monthly figures of some items have reflected the impact of the supply which has not followed its usual pattern, the significant shocks to household income and the operating constraints associated with Covid-19. Since the beginning of the pandemic, the monthly inflation figures for some products have shown deviations from their average behavior, causing some figures to be quite different from their short-term forecast (figure IV.2). To some extent, this is due to supply disruptions in the goods and services markets. For goods, inventory problems, attributable to production and/or logistical issues, have continued to exert pressure on some prices, while others have eased. Meanwhile, in services, operating difficulties have prevented the partial or total resumption of certain items. As pointed out in the technical note issued by INE together with February's CPI, the general imputation of prices is somewhat higher than at the statistical closure of the last MP Report. The highest imputation rates performed by INE continue to be in the Restaurants & hotels and Recreation & culture categories.

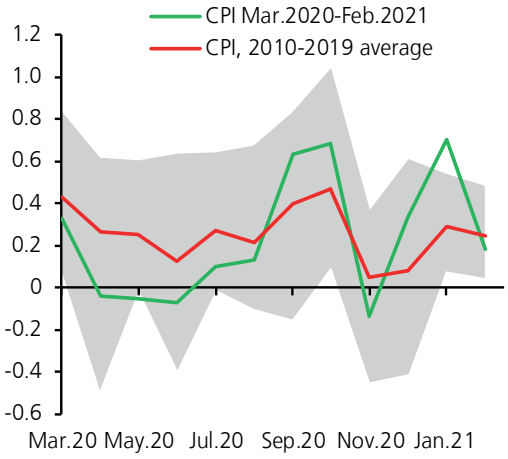
[1]/ Unless otherwise noted, the series of inflation and its components use indexes with the 2018=100 annual base, so they are not strictly comparable with previous figures.

FIGURE IV.1 INFLATION INDICATORS (1) (2)
(annual change, percent)

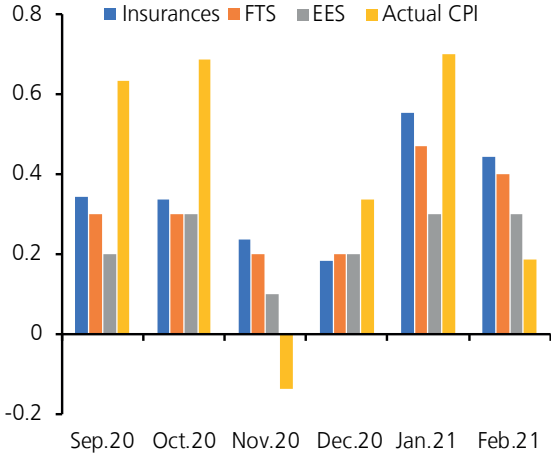


(1) Dotted vertical line shows statistical close of December 2020 Report. (2) In parentheses, share in total CPI basket. (3) For further details, see Box IV.1 in December 2019 Report and Carlomagno and Sansone (2019).
Sources: Central Bank of Chile and National Statistics Institute (INE).

FIGURE IV.2 MONTHLY CPI (1)
(monthly change, percent)



IPC: MARKET EXPECTATIONS AND ACTUAL DATA (2)
(percent)

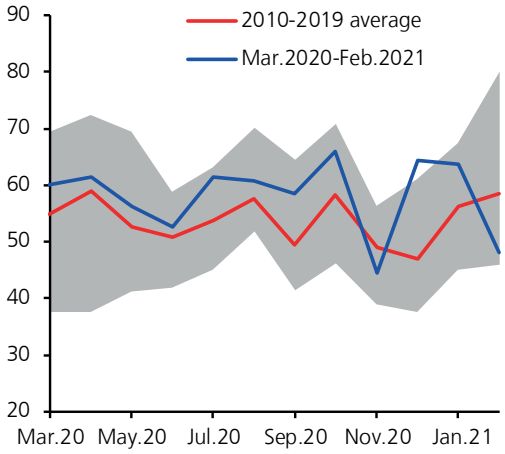


(1) Gray area shows range between highest and lowest monthly CPI in period 2010-2019. (2)The latest data published prior to the respective month's CPI is used.
Sources: Central Bank of Chile, National Statistics Institute and Tradition Chile.

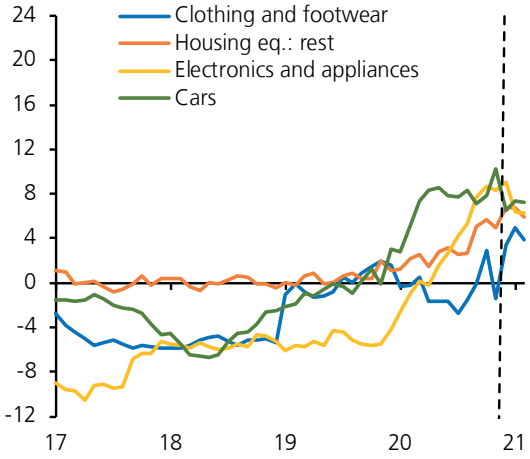
Goods prices continued to be the main driver of inflation, in a context of strong demand and yet-to-be fully resolved supply constraints. The increase in households' available liquidity in the second half of 2020 has sustained the high demand for several imported products, particularly technology and automobiles. Supply restrictions and low inventory availability in some of these products led to significant price increases in some months of 2020[2]/ (figure IV.3). As of February, core inflation for goods stood at 4.6% annually (4.4% in November).

Although some inventories have recovered, in synchrony with an increase in imports of products such as automobiles, electronics and home appliances, supply problems persist in some markets (figure IV.4). Meanwhile, the peso's appreciation since December has taken pressure off the prices of some goods. Inflationary pressures on these goods are expected to continue to ease in the coming months as the economy returns to its normal behavior and the exchange rate' appreciation is passed through to prices.

FIGURE IV.3 CORE GOODS: SHARE OF PRODUCTS WITH POSITIVE MONTHLY VARIATION (1)
(percent)



EXAMPLES OF GOODS AFFECTED BY HIGH DEMAND (2) (3)
(annual change, percent)

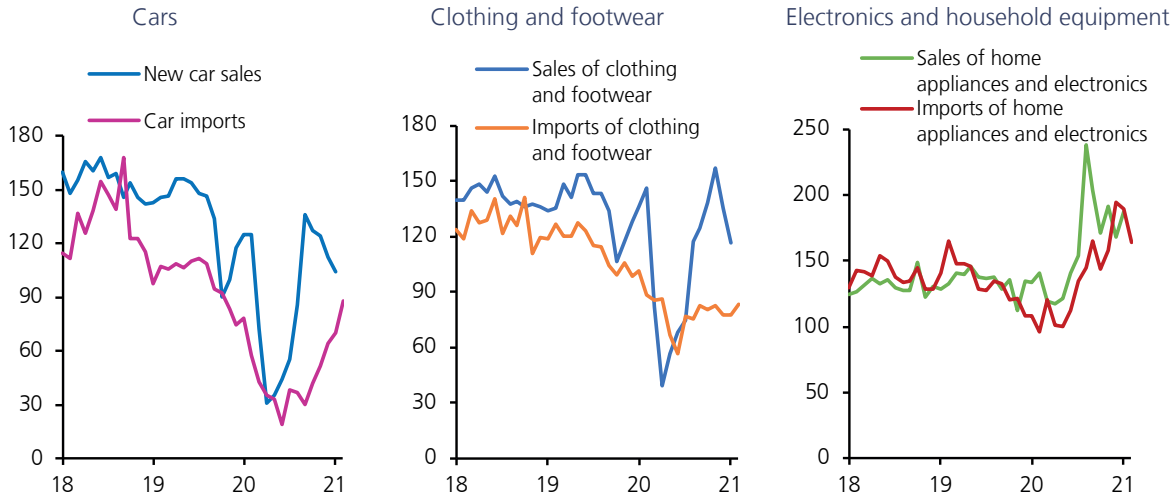


(1) Gray area shows range between highest and lowest montly figures iin period 2010-2019. (2) Shows evolution of CPI sub-indexes for selected groups of goods. (3) Dotted vertical line marks statistical cutoff date of the December 2020 Monetary Policy Report.
Source: Central Bank of Chile.

Services inflation remains contained, amid a slower recovery of activity in these items, and restrictions on mobility and operation of businesses that mantain the price imputations. As in most of 2020, services remain weak and affected by the setbacks in the Step-by-Step plan, which have prevented some sectors to resume business partially or completely. Thus, the number of products with positive monthly variations remains low from a historical perspective (figure IV.5). In sum, the annual variation of core inflation in services stood at 2.2% in February (2.3% in November).

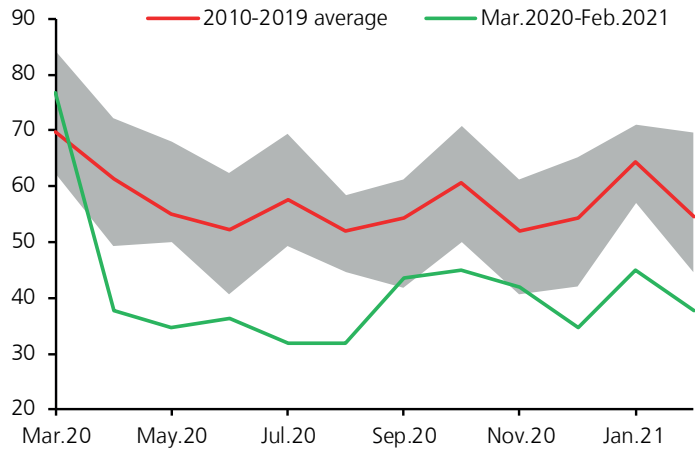
[2]/ See Box IV.1 in December 2020 Monetary Policy Report.

FIGURE IV.4 REAL IMPORTS AND SALES (*)
(index, average 2014=100, seasonally adjusted)



(*) Nominal imports deflated by CPI of new cars, clothing & footwear, and electronics (includes: home appliances, fax machines, audio equipments, and cell phones), as appropriate. Imports of home appliances and electronics include cell phones, computers, tv sets, and household equipment.
Sources: Central Bank of Chile and National Statistics Institute (INE).

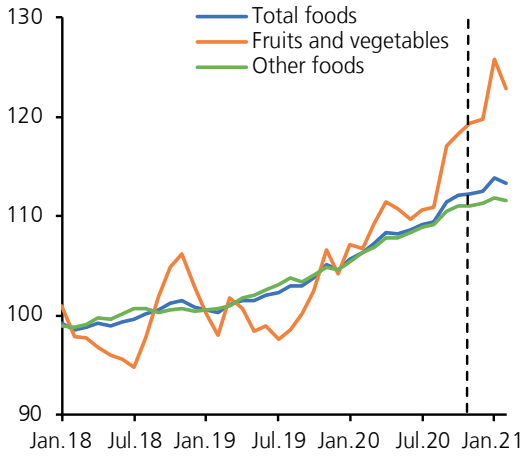
FIGURE IV.5 CORE SERVICES: SHARE OF PRODUCTS WITH POSITIVE MONTHLY VARIATION (*)
(percent)



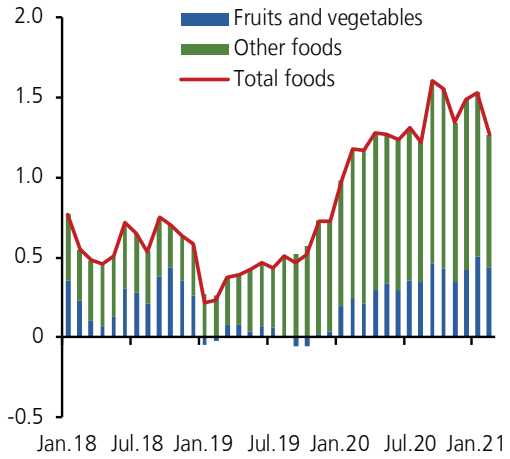
(*) Gray area shows range of highest and lowest monthly figures in period 2010-2019.
Source: Central Bank of Chile.

Food prices show a partial reversal of last year's hikes, but continue to have a high impact on annual inflation. In particular, the sustained rise in the prices of fruits and vegetables over the last year stands out, and after reaching their historical peaks in December 2020 and January 2021, they made a partial turn in February (figure IV.6). Behind this rise are several factors, some more transitory, derived from the pandemic, such as logistical restrictions and the higher demand observed in this period, and others more structural, such as the drought and its effects on production. Other food products also accumulated positive inflation in the past few months, although their contribution to annual figures remains fairly constant. This occurs in a context in which the pandemic has also caused some disruptions in global production and exports. In addition to new demand drivers, such as the global economic recovery and, in particular, higher demand from China, which have pushed world prices upwards. Last February, the FAO food index rose further, posting annual growth of 16.7%. In the aggregate, food inflation recorded an annual variation of 6.5% in February (6.8% in November).

FIGURE IV.6 FOODS CPI (*)
(index, base 2018=100)



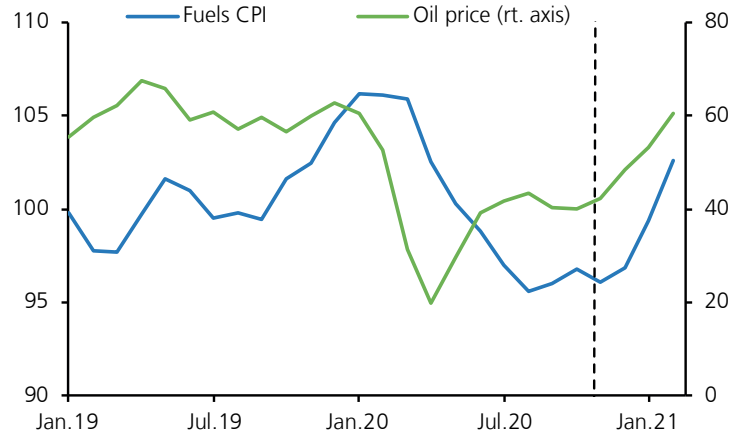
CONTRIBUTION OF FOODS TO ANNUAL INFLATION
(percentage points)



(*) Dotted vertical line marks statistical cutoff date of the December 2020 Monetary Policy Report.
Sources: Central Bank of Chile and National Statistics Institute (INE).

Energy-related inflation has been increasing, in line with the recovery of external prices. The oil price has risen significantly in recent weeks, to levels of around US$60 per barrel (Brent-WTI average) in early March (close to 35% above the statistical close of the previous Report). These figures are in stark contrast to their single-digit or even negative values at the beginning of the pandemic. This price recovery, in line with the internal adjustment mechanism (MEPCO), has been passed on to local market prices and will continue to have an effect going forward (figure IV.7). In annual terms, the energy CPI constrained its fall to -2.3% in February (-4.2% in November).

FIGURE IV.7 FUELS CPI AND OIL PRICE (1) (2)
(index, base 2018=100; dollars per barrel)



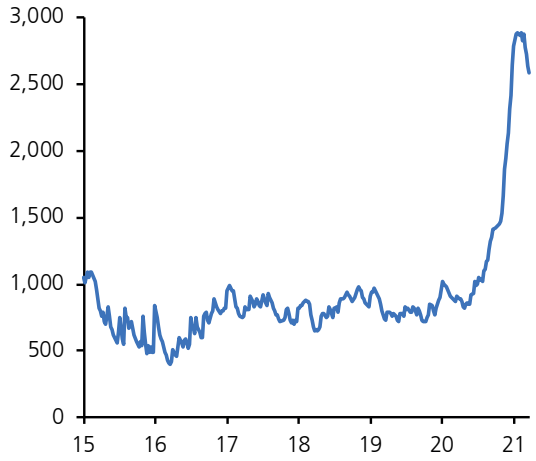
(1) Dotted vertical line marks statistical cutoff date for December 2020 Monetary Policy Report. (2) Average price per barrel of Brent and WTI oil.
Sources: National Statistics Institute (INE) and Bloomberg.

Cost pressures linked to shortages of certain inputs and logistical problems have continued in some sectors. In the February Business Perceptions Report (IPN), this situation was reported mainly in sectors such as construction, which reported lack of materials. Commodity-importing firms reported a similar reality. On the one hand, this was attributed to logistical issues, such as the high cost of maritime transportation, a scenario that is ratified in the upward trend of these services worldwide (figure IV.8). On the other hand, it was also linked to production problems and inventory depletion. Three-month cost expectations collected by the IMCE rose since the previous statistical close, rising above their historical averages during February. However, this situation is expected to normalize in the coming months as imports recover and inventories are replenished.

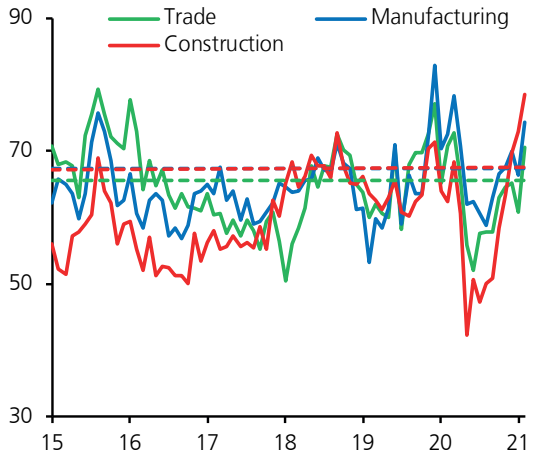
Labor cost pressures are not yet high, as the labor market's recovery is lagging behind activity and, therefore, maintains a significant employment gap with respect to pre-pandemic levels, according to INE figures. The salary indicators published by the entity —IR and CMO— rose in January; however, employment maintains significant differences with its levels of early 2020, even though vacancies have increased and inactivity has dropped. Along these lines, unit labor costs (ULC) constructed with information from the INE show successive annual falls, particularly for sectors such as manufacturing and trade (figure IV.9), a situation that can be explained, in part, by the fall in salaried employment. But this is also consistent with the information gathered in the IPN, which shows that some firms were able during the pandemic to achieve significant productivity gains by restructuring their staff or implementing technological changes. Six-month wage expectations collected by the February IMCE are at around their historical averages.

FIGURE IV.8 INPUT COSTS AND EXPECTATIONS

Cost of maritime freight at global level (1)
(dollars)



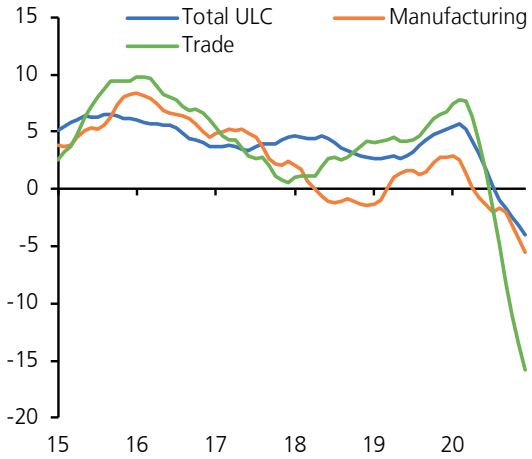
IMCE: Costs expectations (2) (3) (4)
(diffusion index)



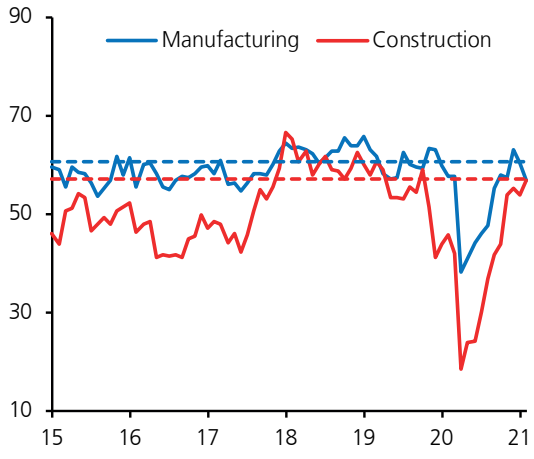
(1) Weekly data from Shanghai Containerized Freight Index that weights the prices of 15 routes from Shanghai, for a 20-foot container. (2) Value above (below) 50 indicates expected expansion (contraction). (3) Dashed horizontal lines show historical averages from January 2004 through February 2021 for each series. (4) Cost expectations three months ahead.
Sources: Bloomberg and Icare/Universidad Adolfo Ibáñez.

FIGURE IV.9 LABOR COSTS AND EXPECTATIONS

Nominal unit labor costs (1)
(annual change, percent)



IMCE: Salaries expectations (2) (3) (4)
(diffusion index)



(1) 12-month moving average of annual changes. (2) Value above (below) 50 indicates expected expansion (contraction). (3) Dashed horizontal lines show historical averages from January 2004 through February 2021 for each series. (4) Salaries expectations six months ahead.
Sources: Central Bank of Chile, National Statistics Institute (INE) and Icare/Universidad Adolfo Ibáñez.

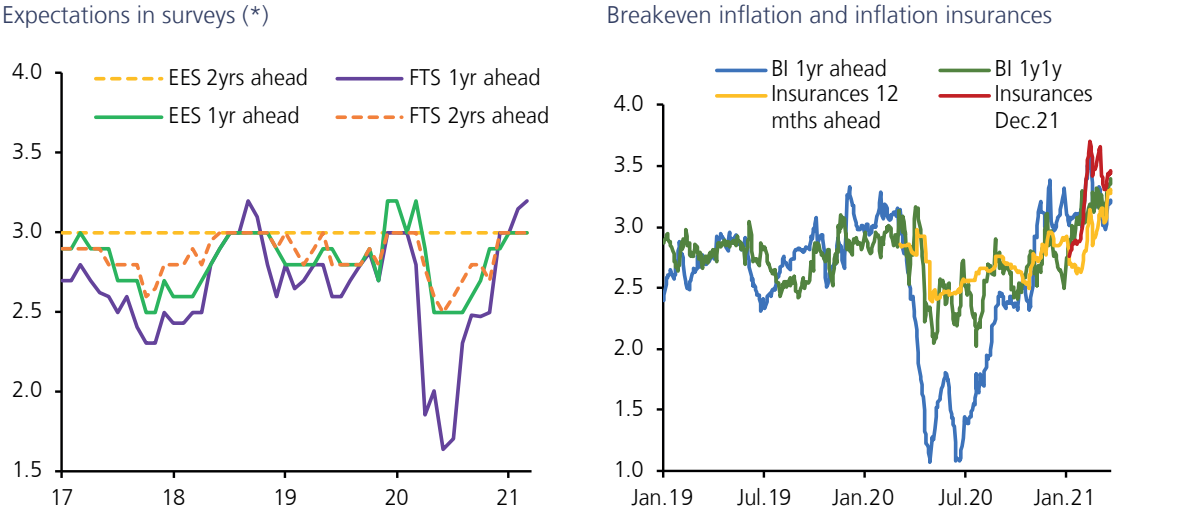
INFLATION OUTLOOK

Consumer and business price perceptions point to some increases in going forward. Consumers' expectations according to the IPEC have shown an upward trend in the share of people who believe that the prices of goods will rise a lot in the next twelve months, with the March indicator higher than ever since early 2012. According to the February IPN, comparable percentages of firms had changed their prices up or down in the last three months, while a slightly higher percentage of firms expected to raise prices in the next three months. Meanwhile, the February IMCE shows an increase in three-month sales price expectations across the board in the construction, manufacturing and trade sectors.

Inflation expectations contained in market surveys have been adjusted upward for this year, while two years ahead they remain fairly stable since the close of the last Report. At December 2021, the median of the March Economic Expectations Survey (EES) rose to 3.2% (2.8% at the statistical close of the December Report). In the one-year term, the March EES rose to 3% (2.9% in December) and the median of the Financial Traders Survey (FTS) for the second half of March stood at 3.2% (3% in December). Two years ahead, both the EES and the FTS remain at 3% (figure IV.10).

Expectations derived from financial asset prices depict a transitory rise in inflation in the short term. Inflation insurances anticipate annual inflation close to 4% at mid-year and 3.4% in December 2021. In the twelve-month term, they have remained at 3.3% with respect to the previous statistical close. One-year and two-year breakeven inflation, as contained in the swaps, exhibit values not very different from the December statistical close, and fluctuate at around 3%.

FIGURE IV.10 INFLATION EXPECTATIONS
(annual change, percent)



(*) In the case of the FTS, it uses the survey of the first two weeks of each month up to January 2018. From February 2018, it considers the last survey published in the month, including the one published on 25 March 2021. In the months in which no survey is published, the latest one available is used.
Sources: Central Bank of Chile, ICAP and Tradition Chile.

In the central scenario, inflation is expected to temporarily approach 4% in the coming months, mainly reflecting energy prices, starting its convergence towards the policy target in the second half of the year. In the near future, the greater impact of the volatile components of the basket, particularly higher fuel prices, stand out. These have not only increased in recent months, but also compare with the low basis of comparison of mid-2020. The core component would face more moderate pressures than in previous months due to the effect of the transmission of the exchange rate appreciation to goods and the impact of supply constraints on services, although firther increases in the prices of products facing higher demand and/or are more affected by supply constraints are not ruled out. Briefly, core inflation is projected to fall to 2.6% by the end of the year. In the medium term, inflationary pressures remain in line with the 3% target, as supply constraints dissipate and the economy closes the existing capacity gaps.

V. FUTURE EVOLUTION OF MONETARY POLICY

The Chilean economy has recovered faster than anticipated, as the different activities have learned to adapt to the pandemic context, the external outlook has improved, and as it has been supported by monetary and fiscal policy, as well as measures that have increased household liquidity. Thus, the level of activity reached between late 2020 and early 2021 provided a better starting point for this year's growth projections. Although in the immediate future the tightening of sanitary restrictions will set back the recovery during part of the second quarter, there are several factors improving the macroeconomic outlook over the projection horizon. These include the increased impulse from abroad; the new accumulated evidence that the successful vaccination process will enable progress to be made toward advanced openness during the second half of the year; and the continued adaptation that various economic sectors have shown throughout the pandemic. Of course, these positive developments are tempered by the weakened financial situation of some businesses and households, and the slow recovery in employment relative to activity. In addition, significant risks remain concerning the evolution of the sanitary situation and the possibility of a deterioration in international financial conditions. In this context, the Board considers that, even as the outlook for the economy has improved, the convergence of inflation to the target in the policy horizon requires that monetary policy remain highly expansionary.

ACTIVITY AND DEMAND PROJECTIONS

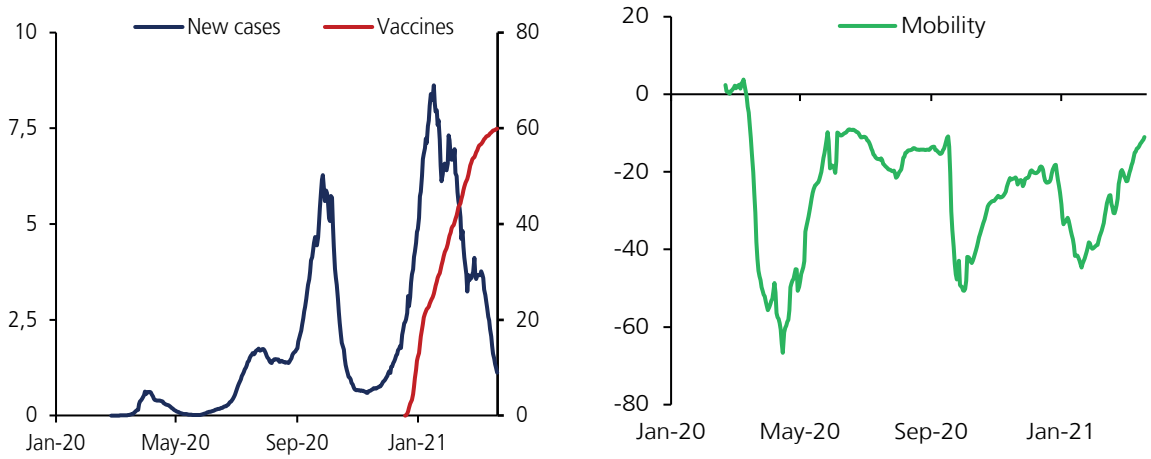
The way various sectors have adapted to operate in a pandemic has enhanced the speed of recovery in recent months. As a result, the level of activity in the first quarter—the starting point for the projections—is revised up from the December forecast. The improved figures show a greater capacity to adapt during the pandemic, through the implementation of various protocols and new working modes that reduce the possibility of infection; there are more workers with temporal working permits during confinement periods, and a strong development of online sale channels and other remote activities. Thus, sectors such as trade and manufacturing have already matched and/or exceeded pre-pandemic levels of activity, while others are on the way there.

Another factor in the fast recovery has been a more favorable external scenario, particularly because our main trading partners have also recovered above expectations and the prices of Chilean exports, especially copper, have increased significantly.

Going forward, various elements will be crucial for the recovery during the projection horizon. On the sanitary level, the immediate effects of the sharp increase in the number of cases contrast with the improved outlook for the impact of vaccinations on the opening of the economy. The deterioration of the epidemiological situation in recent weeks has meant that, at the time of publication of this Report, about 85% of the population is in the strictest phase of the Step by Step Plan. The central scenario assumes that, during April, the severity of the general restrictions will be similar to what it was in the last week of March, including the possibility that some of the country's districts advance while others recede in the phases of the

aforementioned plan. Subsequently, for the middle of the second quarter, the central scenario considers that there will be a gradual opening. These projections are based on the vaccination campaign unfolding as planned, an assumption that does not differ from the December estimate. However, since then, more information has been received regarding the supply of vaccines and the capacity of different sectors to adapt to sanitary restrictions. In addition, there is new information on the effect of vaccination on the easing of sanitary restrictions in countries that are more advanced in the inoculation of their population, such as the United Kingdom and Israel. Although, as in Chile, the process in Israel almost coincided with a sharp increase in infections, after a few critical weeks the number of cases began to subside, and it has now been possible to move forward with the partial opening of borders, as well as resuming services in hotels, shopping centers, attractions, places of worship and some events for people who can provide proof of immunization (figure V.1). Hence, the central scenario contemplates that, if the process continues at the speed announced by the authority, an advanced opening of the economy will be achieved in the second half of this year, somewhat sooner than assumed in December.

FIGURE V.1 ISRAEL: VACCINATED, INFECTIONS AND MOBILITY (*)
(thousands of new cases, percentage)



(*) Seven-day moving average of new cases. For vaccines, the total percentage of the population that has at least one dose is considered. Mobility corresponds to the average of all locations of Google Mobility Index, except Parks and Residential.

Source: Central Bank of Chile based on Google's Covid-19 community mobility report and Our World in Data.

The above background translates, at the margin, into improved activity levels over the projection horizon. In particular, the central scenario considers that GDP will grow between 6% and 7% this year, slightly above the December forecast (table V.1). This is enhanced by the basis of comparison left by the downturn of 2020, the high starting point at the beginning of 2021, the better international scenario, the continuous adaptation of households and companies to the conditions imposed by the pandemic and the favorable assessment of the effect that mass inoculation will have on the opening of the economy. All these factors more than offset the further decline of the coming months derived from tighter restrictions—which, in fact, are expressed in a second-quarter GDP contraction with respect to the first quarter. Going forward, the rates of expansion of activity will converge towards its trend with some delay, so growth is foreseen between 3% and 4% in 2022, and between 2.5% and 3.5% in 2023. Monetary and fiscal policy support will continue to play a key role in these projections. Regarding the latter, the central scenario envisages maintaining the momentum during this year, adding to the approved budget the additional measures announced at the close

of this Report. In the coming years, this momentum will be reduced as the sanitary emergency subsides and progress is made in the fiscal consolidation process. It also considers that the constitutional discussion process will follow the expected institutional channels and that there will be no resurgence of generalized episodes of violence affecting the economy.

TABLE V.1 ECONOMIC GROWTH AND CURRENT ACCOUNT

	2020 (e)	2021 (f)	2022 (f)	2023 (f)
	(annual change, percent)			
GDP	-5.8	6.0-7.0	3.0-4.0	2.5-3.5
National income	-4.7	8.9	3.1	2.3
Domestic demand	-9.1	11.7	3.1	2.7
Domestic demand (w/o inventory change)	-7.9	11.0	2.8	2.8
Gross fixed capital formation	-11.5	9.2	4.9	3.3
Total consumption	-6.8	11.5	2.2	2.7
Goods and services exports	-1.0	3.5	4.3	3.7
Goods and services imports	-12.7	21.4	3.6	2.9
Current account (% of GDP)	1.4	-0.9	-1.6	-2.4
Gross national saving (% of GDP)	21.2	19.1	19.3	18.9
Gross national investment (% of GDP)	19.8	20.0	20.9	21.2
GFCF (% of nominal GDP)	20.9	20.5	21.2	21.6
GFCF (% of real GDP)	20.7	21.2	21.6	21.6
		(US$ million)		
Current account	3,370	-2,700	-5,300	-8,400
Trade balance	18,369	17,800	15,900	12,300
Exports	73,485	94,900	95,600	95,200
Imports	55,116	77,100	79,700	82,900
Services	-4,998	-5,500	-7,000	-7,400
Rent	-10,964	-16,800	-16,000	-15,100
Current transfers	963	1,800	1,800	1,800

(e) Estimate.

(f) Forecast.

Source: Central Bank of Chile.

On the expenditure side, these projections imply double-digit growth in private consumption this year, reflecting the low basis of comparison, the pending effects of pension savings withdrawals, and a gradual reopening that will eliminate restrictions on the consumption of some goods and services. After contracting by 7.5% in 2020, the central scenario of this Report considers that this year private consumption will expand by around 12%, a figure in which the low base of comparison plays an important role. In the December Report, it was estimated that the cumulative effect of the two pension fund withdrawals would be in the order of 2.8% of GDP between 2020 and 2021, considering that much of these resources would be invested in other savings instruments and debt repayment, and that the part destined for consumption would be spread out over several quarters. The evidence so far validates this assumption. In fact, an analysis of the amounts actually withdrawn from pension savings suggests that part of them were destined to the consumption of goods and the repayment of debts, but almost two thirds still remain in people's bank and savings accounts, a factor that also helps to explain the strong expansion of private consumption this year (table V.2). On the other hand, much of the decline in consumption in 2020 was related to the impossibility of accessing some

goods and, especially, services. Actually, the pandemic has strongly affected activities that require greater human interaction due to required distancing, so that recreational activities, entertainment and tourism, for example, have been severely curtailed. Once the evolution of the pandemic allows a greater opening of these activities and the fear of contagion is reduced, the economy should see greater dynamism with the release of repressed spending on those items.

TABLE V.2 ESTIMATED DISTRIBUTION OF THE USE OF WITHDRAWN PENSION SAVINGS (*)

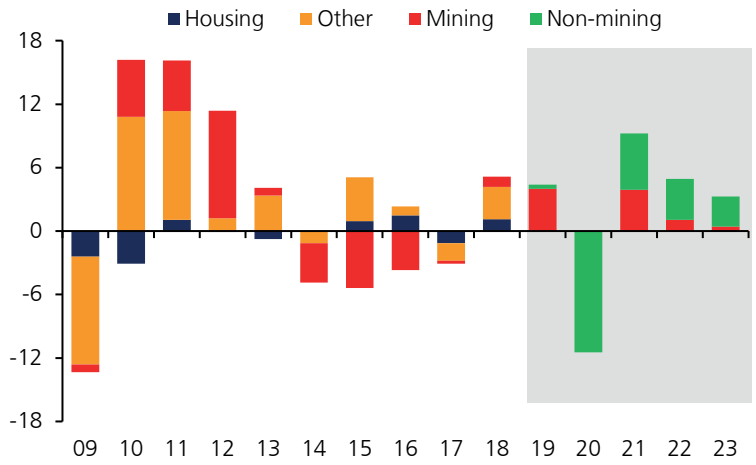
	CLP billion	Percent of total	Percent of GDP
Withdrawals up to January:	24,500	100.0	12.2
Assets:	15,233	62.2	7.6
Sight and current accounts	8.984	36.7	4.5
Traditional savings	4,092	16.7	2.0
Pension savings	910	3.7	0.5
Savings accounts for home purchase	449	1.8	0.2
Default debt repayment and rescheduling	798	3.3	0.4
Consumption of goods	3,734	15.2	1.9
Not identified	5,532	22.6	2.8

(*) Increase in assets estimated by comparing changes in specific aggregate accounts' balances with respect to July 2020. Included accounts are: sight and current accounts of natural persons, savings accounts of natural persons (term savings and "cuenta 2"), pension savings (APV --voluntary--, agreed deposits and similar in AFP (mandatory) and entities regulated by the CMF), savings for housing and delinquency (portfolio with 90-day delinquency or more in the banking system). Consumption of goods calculated as the difference between estimated effective expenditure based on Transbank data and an estimated counterfactual consumption considering the evolution of household income in the absence of withdrawals taken from Barrero et al. (2020). Not identified could include cash, savings in unregulated instruments, repayment of non-bank debts, prepayment of non-bank debt, loan prepayment, et cetera.

Source: Central Bank of Chile based on Barrero et al (2020), CMF, INE, Superindence of Pensions and Transbank.

Although investment fell more sharply than consumption, its recovery is expected to be slower due to high uncertainty and the greater financial burden of many companies. In any case, this year's growth projection for gross fixed capital formation (GFCF) is up from December. This takes into account the positive surprise shown by the data on machinery and equipment imports so far in 2021 and the good closing of construction at end-2020. Going forward, for the construction and works component, the lead players will be public investment and, to a lesser extent, mining investment. For the former, the public budget for 2021 contemplates an increase of nearly 35% in real terms. For the latter, the persistence of high copper prices has already begun to translate into the acceleration of some projects that allow speeding up production, while also incorporating the rescheduling of projects that had been previously shelved. The Survey of the Capital Goods Corporation reports projects postponed to 2022 and 2023 due to the greater expected impact of the pandemic-related contingency. Meanwhile, non-mining productive investment will continue to lag behind in the central scenario (figure V.2). Beyond the uncertainty imposed by the sanitary situation and the evolution of the process of institutional changes on which the country is embarked, some companies point out that the financial burden is limiting their capacity to invest, as noted in the February Business Perceptions Report. Thus, after representing close to 20% of nominal GDP in 2020, the GFCF will increase gradually in the next years, to reach 21.6% in 2023.

FIGURE V.2 REAL ANNUAL CONTRIBUTION TO GFCF (*)
(percentage points)



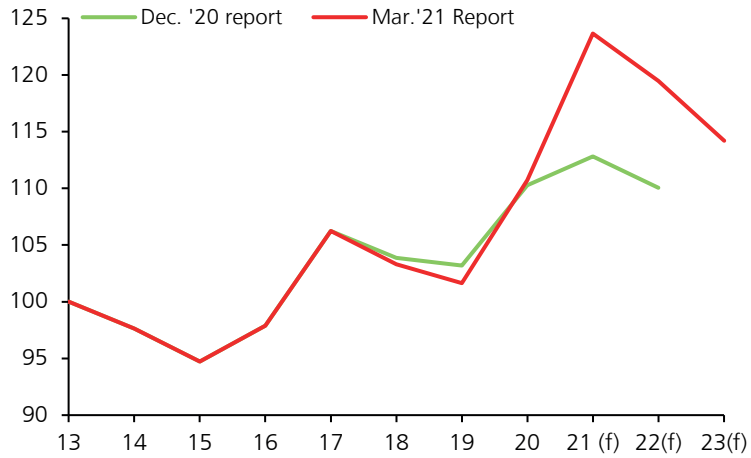
(*) Until 2018 effective data is used. Total GFCF for 2019-20 as published on March 18, 2021. The Other GFCF component is treated as a residue. For 2019-22, forecasting models from the Central Bank and sectoral sources are used, such as investment plans and the CBC Survey.

Source: Central Bank of Chile.

The fall in consumption outpaced the contraction in income, resulting in an increase in private savings that was only partially offset by government dissaving. This, together with the fall in investment, led to a significant reversal of the current account balance. It went from a deficit of 3.7% of GDP in 2019 to a surplus of 1.4% of GDP in 2020. It must be noted, however, that there is no evidence to connect the change in the current-account balance with external funding constraints, which is usual in this type of developments. From a compared perspective, the current account reversals during the Covid-19 crisis were common in emerging countries and somewhat less frequent in developed ones. In the latter case, probably the existence of a more extended social safety net enabled a more rapid expansion of fiscal transfers, which mitigated some of the aforementioned determinants, sustaining higher levels of aggregate spending. By 2021 and 2022, insofar as these factors disappear, the current account will return to a deficit (0.9% and 1.6% of GDP, respectively). In any case, it will be lower than what was anticipated in December. The increase of close to 10% in the terms of trade over the projection horizon plays an important role in this, due to the increase in the value of mining exports that this entails (figure V.3). In both years, this increase is not enough to be counterbalanced by the rebound in imports that the expected oil price hike will bring about and the recovery of the economy per se. Given that the rise in export prices is stronger this year, the current account at trend prices[1]/ will post a deficit this year very similar to the 5.4% of GDP forecast in December. By 2022 the quantities effect will be reflected more strongly, so that at trend prices the current account deficit will be 5.5% of GDP.

[1]/ This measure adjusts the value of mining exports and fuel imports considering deviations of copper and oil prices from their long-term values. The same is done for rents and transfers associated with copper exports. Other exports and imports are valued using current prices. In addition, it does not correct for possible changes in the quantities exported or imported due to movements in copper and oil prices. The calculation considers a long-term copper price of US$2.7 per pound and an oil price of US$70 per barrel (boxes V.2 in the September 2012 Report and V.1 in the December 2015 Report).

FIGURE V.3 TERMS OF TRADE
(index, 2013=100)



(f) Forecast
Source: Central Bank of Chile.

One important factor in the recovery of the Chilean economy will be the stronger external boost derived from both the dynamism shown by our main trading partners and higher expected terms of trade. The central scenario revises upward the trading partners' growth forecast, especially strong in 2021 (when it goes from 5.5% to 6.3%) (table V.3). Aside from the fact that towards end-2020 there was also greater-than-expected recovery in many economies around the world, this revision is explained primarily by the effects of the substantial fiscal stimulus package that was approved in the United States (amounting to around 9% of 2020 GDP) which will steer the US economy to grow 6.7% this year. Other economies will also be favored by fiscal measures, notably the United Kingdom and Japan. China will continue to sustain the world's recovery thanks to public investment and increased external demand for its products. At the same time, the central scenario contemplates a comparatively more lagging situation in Latin America and Europe. While projections consider the higher effective numbers of these economies, in both blocs a slowdown is expected due to the extension and/or tightening of sanitary restrictions and vaccination processes that are taking longer. As in Chile, the assumption is that as the pandemic goes away and companies around the world go back to business as usual, part of the precautionary savings and/or contained expenditure will be possible to reverse. Trading partners' growth projections for 2022 and 2023 do not change, and are expected to gradually converge to their long-term growth rates.

TABLE V.3 WORLD GROWTH (*)

	Avg. 10-19	2020 (e)	2021 (f)	2022 (f)	2023 (f)
World GDP at PPP	3.7	-3.3	6.2	4.4	3.5
World GDP at market exchange rate	3.1	-3.6	5.8	4.1	3.0
Trading partners	3.8	-2.3	6.3	4.2	3.5
United States	2.3	-3.5	6.7	3.9	2.2
Eurozone	1.4	-6.8	4.0	4.3	2.9
Japan	1.3	-4.9	2.9	2.2	1.2
China	7.7	2.3	8.7	5.2	5.3
India	7.1	-7.1	10.0	5.8	6.1
Rest of Asia	4.5	-2.7	6.0	4.7	3.5
Latin America (excl. Chile)	1.7	-7.2	3.8	3.2	2.3
Commodity exp.	2.4	-4.5	4.7	3.6	2.4

(*) For definitions, see Glossary.
(e) Estimate. (f) Projection.

Sources: Central Bank of Chile based on a sample of investment banks, Consensus Forecasts, IMF and statistical offices of each country.

The hike foreseen in the terms of trade is based primarily in average copper prices of US$3.95, 3.75, and 3.55 per pound in 2021, 2022, and 2023, respectively, assuming that several of the factors that pushed the price to its peaks of the las decade will dissipate, but not disappear. Among the factors behind the copper price hike is the fast rebound of China, although its government's intention of boosting consumption versus investment as the driver of growth would reduce the impulse of copper demand in the times ahead. Likewise, despite interruptions in the operation of some relevant deposits triggered a fall in global supply after almost twenty years, if the high prices persist they should encourage investment in new projects. The depreciation of the dollar and the increase in global liquidity also triggered a widespread rise in commodity prices, but projections estimate that the new fiscal package in the US may generate a dollar response in the opposite direction going forward. More permanent will be the impact of the transition to less polluting energy sources due to, for example, China's announcements of zero carbon, the US rejoining the Paris Agreement and the EU's announcement that it will destine 30% of its recovery budget to invest in climatic transition. This will result in increased demand for electric vehicles and other investments in renewable energy sources whose production is highly copper intensive. Although the oil price has also seen important hikes (more than 40% after the close of the December Report), and higher fuel prices are foreseen in the projection horizon, this effect cannot offset the foreseen evolution of copper. So, the terms of trade will be —on average—10% higher than predicted in December throughout the projection horizon, mainly because of the increase they already saw towards the end of 2020 and the turn of 2021 (table V.4).

TABLE V.4 INTERNATIONAL BASELINE SCENARIO ASSUMPTIONS

	Avg. 10-19	2020	2021 (f)	2022 (f)	2023 (f)
			(annual change, percent)		
Terms of trade	1.1	8.9	11.7	-3.4	-4.4
External prices (in US$)	0.6	-1.5	6.9	2.0	2.2
			(levels)		
LME copper price (US$cent/pound)	306	280	395	375	355
WTI oil price (US$/barrel)	72	39	60	58	55
Brent oil price (US$/barrel)	80	42	63	61	59
Gasoline parity price(US$/m3) (*)	610	333	505	490	476
US Federal Funds Rate (%)	0,7	0,5	0,3	0,3	0,6

(*) For definition, see Glossary.

(e) Estimate

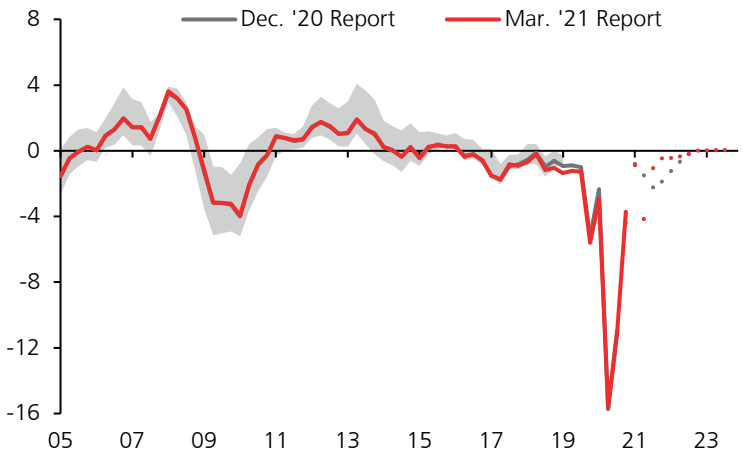
(f) Forecast.

Source: Central Bank of Chile.

CAPACITY GAPS

Estimations are that potential GDP rose towards end of 2020 in light of how various sectors have adapted and the resulting increase in productivity. This effect was more than offset by the recovery of effective GDP, which further closed the activity gap (figure V.4). Towards the end of the projection horizon, the baseline scenario assumes a growth range slightly below its estimated trend. However, this estimate is highly uncertain, as the pandemic has had important effects in different areas, such as financial soundness, business productivity or the functioning of logistic chains, which could have mixed effects on medium-term growth capacity. In any case, a more detailed analysis of the structural parameters will be presented in next June's Report, with updates based on a comprehensive analysis by the Board.

FIGURE V.4 ACTIVITY GAP (1) (2)
(levels, percentage points)



(1) Gray area shows minimum and maximum ranges for gap estimates, using different potential GDP estimation methods (trivariate, multivariate, HP, SVAR, MEP and SSA methods). See Fornero and Zúñiga (2017). (2) Dotted lines show forecast.

Source: Central Bank of Chile.

Beyond the size of the gap, several indicators of goods and factors markets attest to the existence of gaps, where the labor market stands out. In line with the performance of activity, there is great heterogeneity across sectors, with large gaps in some services sectors, which have been greatly affected by the reductions in mobility, and smaller ones in those sectors where activity has picked up faster, or which face limitations derived from logistical problems. Although this explains important changes in relative prices, they do not affect medium-term inflation. Although both the supply of and demand for jobs show improvements compared to mid-year, with higher indexes of internet job ads and decreased inactivity than in an average month, the labor market has regained only about half of the jobs lost because of the pandemic. Particularly affected is employment in those sectors that rely the most on human interaction and where working from home is not an option —i.e. lodging, diners, artistic, entertainment and recreational activities. Also worth noting is the fact that inactivity remains high for women, many of which have had to quit their paid jobs to care for children or other family members. Another important characteristic of this stage is that even in sectors where activity has recovered (such as trade), hiring has not kept pace with activity.

CONVERGENCE OF INFLATION

Inflation has been around 3% annually for several months, owing mainly to the effect of volatile prices and supply constraints in a context of strong demand for some goods. Although a decrease in core inflation is expected in the coming months, the volatile component will push headline inflation to near 4% annually by mid year. The volatile part of inflation has been especially affected by fuel prices. These have not only risen in recent months, but their 2020 comparison basis is very low. In fact, between March and December of last year, the Brent-WTI oil average price was close to US$38 per barrel, while it now trades at prices bordering US$60 and projections indicate that it will stay in the vicinity for the remainder of the year. Meanwhile, the appreciation of the peso will take pressure off core inflation for goods, mainly through its effect on imported goods. For forecasting purposes, the pass-through of the exchange rate variation is expected to remain at its historical averages. Regarding the real exchange rate, the central scenario assumes that it will continue to appreciate towards its long-term levels, supported by the increase in the terms of trade, the higher productivity associated with the economy's adaptation to operate in the Covid-19 context, and that the economy will see a comparatively better than the region's trading partners. In the short term, meanwhile, the prices of services, which have been most affected by the constraints imposed by the pandemic, will also contribute to moderating core inflation, an effect that will be diluted as consumption resumes.

TABLE V.5 INFLATION (1)

	2020	2021 (f)	2022 (f)	2023 (f)
	(annual change, percent)			
Average CPI	3.0	3.4	2.9	3.0
December CPI	3.0	3.0	3.0	3.0
CPI in around 2 years (2)				3.0
Average core CPI	2.7	3.0	2.8	3.0
December core CPI	3.3	2.6	3.0	3.0
Core CPI around 2 years (2)				3.0

(1) Core inflation is measured using the CPI excluding volatile.

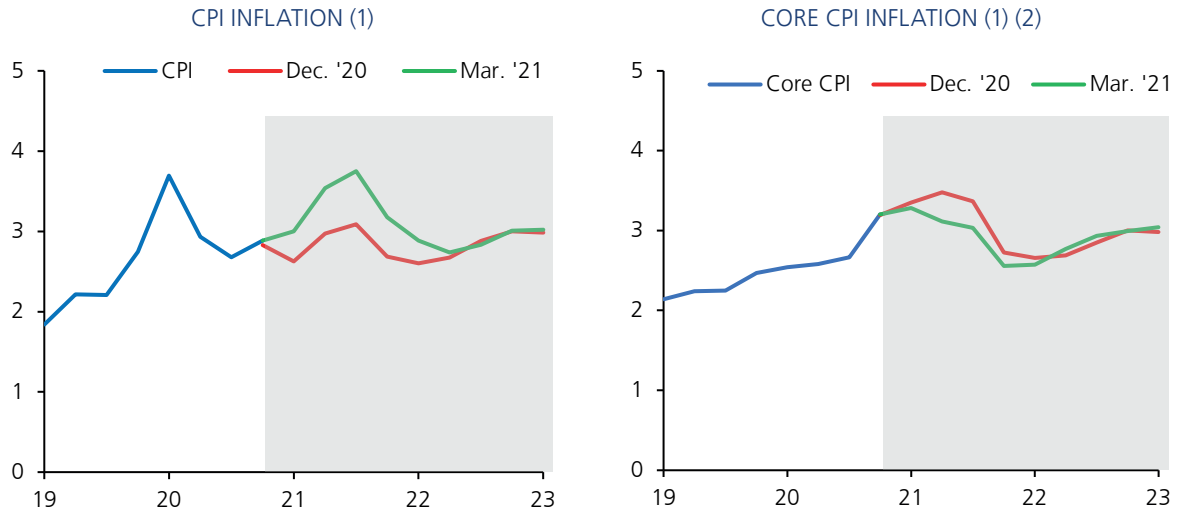
(2) Inflation forecast for the first quarter of 2023.

(f) Forecast.

Source: Central Bank of Chile.

In the medium term, as supply constraints fade out, potential GDP picks up and the economy closes the existent capacity gaps, inflation will converge to the target (table V.5). The central scenario estimates that this convergence will begin in the second half of the year, bringing inflation to 3% by the end of 2020. Considering that the evolution of inflation in the short term will be mainly determined by its volatile component, the core trajectory will run below that of total CPI. In fact, as total inflation rises, core inflation, as measured by the CPI without volatile prices, is projected to fall to 2.6% in the fourth quarter of this year and converge to 3% from below by the end of 2022 (figure V.5).

FIGURE V.5 INFLATION FORECAST
(annual change, percent)



(1) Gray area, as from first quarter 2021, shows forecast.
(2) Core inflation is measured using CPI excluding volatile.
Sources: Central Bank of Chile and National Statistics Institute (INE).

MONETARY POLICY STRATEGY

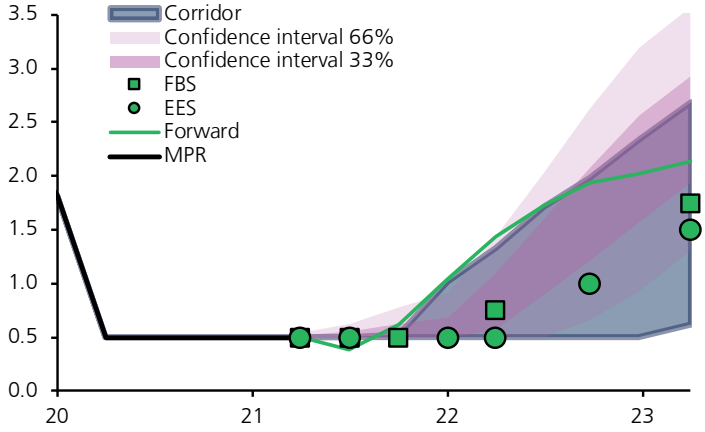
The economy has gradually recovered from the negative shock caused by the pandemic, and once the recent deterioration in health indicators is left behind, it is expected to return to a sustained growth path that will gradually narrow the capacity gaps and allow inflation to converge to the target.

The Board considers that, even as the outlook for the economy has improved, the convergence of inflation to the target in the policy horizon requires that monetary policy remain highly expansionary. Thus, the MPR will be held at its 0.5% minimum until the recovery of the economy takes hold and spreads to the more lagging components of expenditure, which will take several quarters. The Board reiterates that future changes in monetary policy will depend on the evolution of the macroeconomic outlook and its implications for the evolution of inflation.

The unconventional measures will continue to operate under the same conditions in place, complementing the monetary policy stance defined by the MPR. Any future modifications will be announced with sufficient notice.

At any rate, despite the positive recent performance of the economy, several sensitivity scenarios remain, coming mainly from the unprecedented shock caused by the pandemic, that might entail adjusting the future path of monetary policy, as can be inferred from the MPR corridor (figure V.6).

FIGURE V.6 MPR CORRIDOR (*)
(percent)



(*) The corridor is built following the methodology of Box V.1 of the March 2020 Report. It includes the FBS of March 25th, the EES of March 10th and the Forward curve derived from the prices of financial assets at statistical closing. 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 ICP.

Source: Central Bank of Chile.

SENSITIVITY AND RISK SCENARIOS

The course of the epidemiological situation is key to determine how sanitary restrictions will evolve, as they have a significant impact on the expected growth rate. In Chile, the worsening of the sanitary emergency has resulted in the full confinement of nearly 85% of the population as of the closing of this Report, which will have adverse effects on second-quarter economic indicators. In any case, this effect will be milder than at the beginning of the pandemic, as businesses and households, as well as constraints determined by the phases of the Step-by-Step plan, have continued to adapt, and public policies already have a toolkit to deal with the situation and help the most affected. However, delays in the vaccination process, a larger than anticipated increase in infections or the appearance of new strains of the virus complicating sanitary management could be elements that would delay the process of opening the economy. Such a situation would lead consumers to rein in their spending because of fear of contagion, while investment would be reduced due to the greater uncertainty and difficulties in project execution. In line with lower spending, such a scenario would contain inflation, so that monetary stimulus would have to be maintained for longer than assumed in the central scenario, as shown in the lower bound of the MPR corridor.

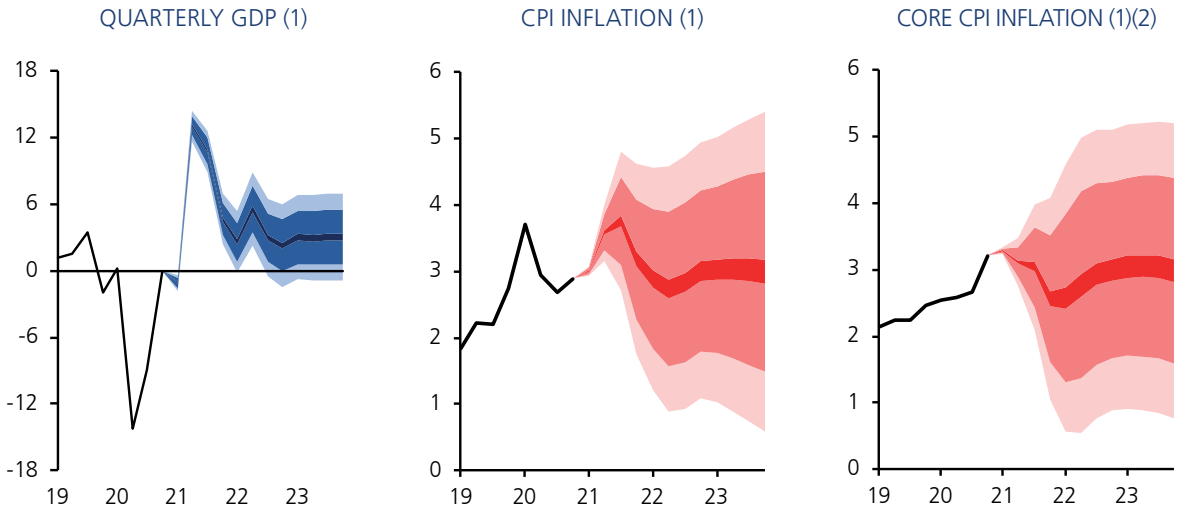
Another element worth attention has to do with the potential magnitude of the scars left by the pandemic. Although tax micro-data show that a significant share of companies that suspended activities went back to reporting sales towards the end of last year, and that household savings saw a significant increase during 2020, doubts persist about the more persistent effects on the productivity and financial health of households and companies. In the central scenario, the main boost to investment in 2021 comes from continuing large-scale mining projects and public investment, while the rest of productive investment will maintain a smaller share. However, despite the resilience shown by companies so far, factors such as increased uncertainty, difficulties in meeting financial commitments, more persistent restrictions or productivity losses, could have a stronger than expected impact on investment and hiring decisions. Actually, beyond the uncertainty inherent to the pandemic, in the February Business Perceptions Report companies point to doubts about the economy, the

political situation, insufficient demand and financing problems as limiting factors when deciding to carry out new projects, and their perspectives regarding staff increases remain very limited. On the employment side, another relevant factor is the possibility of a greater prevalence of telecommuting and the obsolescence of the skills of people who have been unemployed for a longer period, especially if at the same time there have been technological or organizational labor-saving adjustments. A slower recovery of the labor market would lead to a deterioration of expectations, which would result in lower consumption, impacting the growth of activity and inflation. Should such scenarios come into play, the speed of recovery could slow down, prolonging the gaps in the economy and the permanence of the MPR at its technical minimum.

Another possibility is a faster recovery of demand in the second half of the year. Some economic agents have significantly increased their savings during this pandemic in the face of consumption constraints, among others. Compounded with liquidity from pension fund withdrawals, this could result in a faster recovery in spending than implied by the central scenario. To the extent that such behavior is not accompanied by a comparable increase in potential GDP, medium-term inflationary pressures could rise, calling for an earlier withdrawal of the monetary stimulus, in line with the upper bound of the MPR corridor.

On this occasion, after assessing these sensitivity scenarios, the Board estimates that the risk balance is unbiased for both inflation and activity. Still, the possibility remains of more negative risk scenarios, particularly linked to the sanitary evolution of the pandemic, the characteristics of the recovery of other economies and the scars that the crisis will leave (figure V.7).

FIGURE V.7 GROWTH AND INFLATION FORECASTS
(annual change, percent)



(1) The Figure shows confidence interval of baseline projection over the respective horizon (colored area). Confidence intervals of 10, 70 and 90% around the baseline scenario are included. Confidence intervals are built based on the RMSE of averaged XMAS-MEP models from 2009 to 2017. Also, the intervals contain the risk evaluation of growth and inflation performed by the Board.

Sources: Central Bank of Chile and National Statistics Institute (INE).

These estimates also consider risk scenarios whose consequences could push growth outside the range of projections for the coming years. These include a more negative scenario for the pandemic at the global level, as well as adjustments in financial conditions caused by a possible de-anchoring of inflation expectations in the face of significant international fiscal packages. The emergence of new variants of the virus, as well as the delay in the vaccination process in much of the emerging world and in Europe, could result in major extension of confinement measures. In a context where many countries have already tightened their policy space considerably, such scenarios could more severely affect the growth trajectory of our trading partners and the terms of trade over the projection horizon. Meanwhile, the fiscal stimulus package announced in the U.S. to address the pandemic has been very significant (accumulating over 25% of GDP since the arrival of Covid-19), and it is possible that other measures associated with public infrastructure plans will be added. These announcements have temporarily coincided with a significant rise in international long rates. Insofar as such behavior is simply a reflection of improved expectations, this would not halt growth in Chile or other countries whose recovery prospects are temporarily aligned with those of the U.S. However, there is concern in part of the market that the scale of the stimulus in the U.S. could lead to a more abrupt adjustment in inflation expectations and the Fed's rate trajectory, triggering a sharp tightening of global financial conditions, perhaps comparable to what was seen during the taper tantrum of 2013. If materialized, such a scenario could bring the growth projection for Chile down by several points over the projection horizon, while its impact would be particularly severe in emerging countries with worse growth prospects and/or which have accumulated larger macroeconomic imbalances since the start of the pandemic.

BOX V.1:

Dynamics of Chilean firms during the Covid-19 crisis

A key challenge during the Covid-19 crisis has been to design macroeconomic policies that provide support for the survival of companies that, although viable in the medium term, have suffered a major liquidity shock due to sanitary restrictions. In Chile, this motivated the Covid-Fogape credit programs and the Central Bank's Credit Facility Conditional on Increased Lending (FCIC). In addition to providing support for the country's productive capacity, achieving this objective would facilitate an earlier recovery of the labor market and household income. The September 2020 MP Report (Box II.2) contains preliminary evidence of the positive impact of these programs on the survival of firms, but also raised some red flags by showing a significant increase in the number of firms that stopped reporting sales for several months.

This Box complements that analysis in several dimensions. First, it extends to the end of 2020 the evidence of firms "not reporting" for a prolonged period, finding a significant recovery: of every three firms that stopped reporting sales for three months or more, nearly two reappeared on the tax rolls with positive sales. Second, after falling significantly during the worst months of the pandemic, the rate of new business start-ups has risen strongly, contributing to the economic dynamism observed in recent months. The greater number of firms operating since mid-2020, whether new or returning, also resulted in the recovery of commercial interconnections between firms and their suppliers, whose decline had been reported as a cause for concern (Box IV.1, December 2020 MP Report)[1]/. Third, some characteristics of the new firms are examined, finding that their sectoral composition, size, and recruitment intensity are not very different from historical patterns. Although there are many dimensions of analysis remaining to be done before a more complete diagnosis can be made, this background is good news regarding the scale of the scars of the pandemic, suggesting that more negative scenarios regarding the health of the Chilean productive sector could have been averted so far.

Quantifying entry and non-reporting margins in Chile during the Covid-19 crisis

Between February and June 2020, the number of firms reporting sales dropped sharply, from 650 to 550 thousand, equivalent to a drop of close to 15% (figure V.8)[2]/. This trend began to reverse after June, closing 2020 with 670 thousand companies reporting sales, an increase of 3% compared to the start of the crisis[3]/.

[1]/ In the U.S., studies of the dynamics of entry and exit of firms during the Covid-19 crisis shows a similar dynamic, according to data from the US Census Bureau, which publishes weekly statistics on the creation of new firms. There, a dissimilar behavior has been observed over the course of 2020, with a significant drop towards the end of the first quarter strongly influenced by the pandemic and subsequent recovery (Haltiwanger, 2020). In general, firm dynamics as a relevant topic in the study of resource allocation in an economy goes back to at least Schumpeter (1939). In a recent paper, Ates and Saffie (2021) analyze these margins for Chile from a historical perspective.

[2]/ For a firm to be considered as such, its taxpayer ID (RUT) must register sales according to administrative records (Form F29 of the SII, available only in unnamed form at the Central Bank to protect the anonymity of firms and workers). Since there are no real-time records of the definitive exit of companies, the concept of "non-reporting" of sales is used as an imperfect proxy.

[3]/ As a reference, the average annual growth in the number of firms since 2015 is 3%. The qualitative results hold if: a) the number of firms series are seasonally adjusted; ii) an alternative measure of firm is used that conditions reporting employees and having paid contributions to a pension fund and unemployment insurance; and iii) atypical turnover firms are filtered out, i.e. firms that change their RUT periodically but continue with the same payroll, in addition to mergers and acquisitions.

FIGURE V.8 NUMBER OF FIRMS IN CHILE, 2015-2020 (*)
(thousands)

(*) Total firms that report sales in each month by form F29. Red vertical line marks February 2020 —the latest before the arrival in Chile of Covid.
Source: Central Bank of Chile based on form F29 of the Internal Revenue Service (SII).

Panel (a) of figure V.9 presents the monthly flow of entrants —that appear for the first time in the tax records-- and re-entrants —that stopped reporting for three or more months, but then reappeared—. Panel (b) shows those that stopped reporting sales and did not resume reporting throughout the analysis period[4]/. Of particular note is the significant increase in re-entrant firms, which by December 2020 reached a monthly flow of around 40 thousand, up from the low levels of April (20 thousand). Regarding the creation of firms, a drop in the monthly flow is observed, amounting to nine thousand per month at the social outbreak and hitting a low of around six thousand in April 2020, compared to a monthly average of 11 thousand new firms during 2018. This slowdown was reversed from May onwards, with a recovery that peaked close to 13 thousand companies in November. Given its higher volume, the recovery of re-entrant companies is the dominant factor in the evolution of the total number of firms.

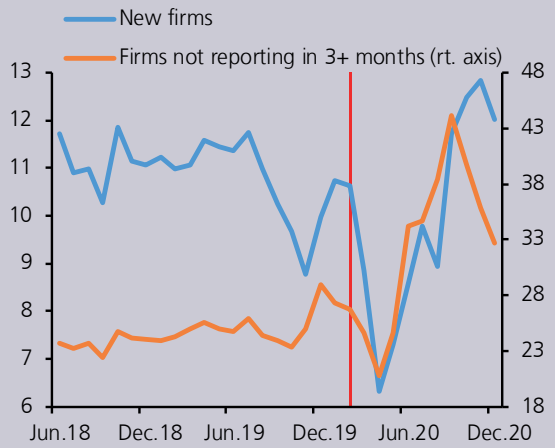
Meanwhile, the number of companies that ceased to report sales until the end of the analysis period (panel b), accelerates at the beginning of the pandemic, reaching a peak of around 30 thousand per month in April 2020. It then stabilizes at levels around 14 thousand per month. This slowdown is a third factor contributing to the recovery in the number of firms.

Figure V.10 analyzes the relative contributions of the above factors, decomposing the change in the number of firms for each of the months between March and December with respect to February 2020. The number of firms that stopped reporting for three or more months is shown by the red bars. The subgroup within this category that resumes sales reporting (i.e., re-entries) are plotted with the yellow bars. The entry of new companies is represented by the green bars. The sum of the three components —net business creation— is represented by

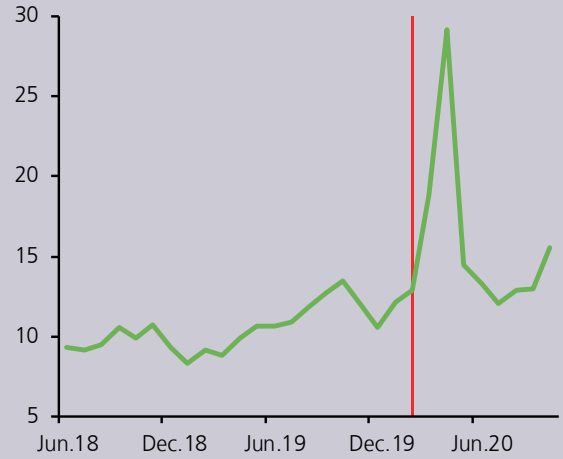
[4]/ The correct measurement of the flow of firms that stop reporting sales faces obvious challenges the closer the end of the sample is. For this, the sample is adjusted by the historical probability of recovery, using the distribution of re-entry of firms at different horizons. This is also adjusted by the information obtained in the pandemic months, when the distribution changed, reflecting a higher re-entry of businesses. With all this, for the sake of prudence, the monthly flow is documented only up to October 2020.

FIGURE V.9 MARGINS OF ENTRY AND NON-REPORTING OF FIRMS, 2018-2020
(thousands)

(a) Entry and re-entry of firms (1)



(b) Firms not reporting sales (2)



(1) Blue curve shows monthly flow of firms reporting sales for the first time. Orange curve (right axis) shows monthly flow of firms reappearing after not reporting sales for three or more consecutive months. Last data is from December 2020. (2) Includes monthly flow of firms ceasing to report positive sales and do not resume reporting over sample period up to January 2021. For the final months of the sample, adjusted by historical probability of recovery; second adjustment made using information obtained in the months of the pandemic. Last observation corresponds to October 2020. Red vertical line in both graphs mark February 2020.
Source: Central Bank of Chile based on form F29 of the Internal Revenue Service (SII).

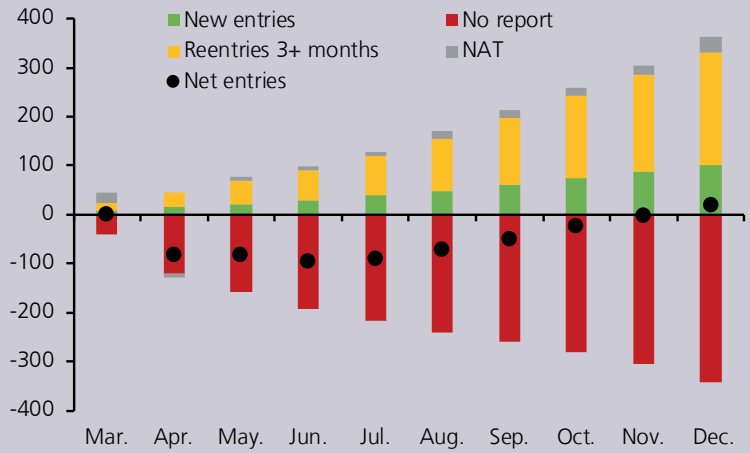
the black dots and, as mentioned above, amounts to about 20 thousand firms between February and December 2020[5]/, which is shown in the last bar of the figure. This cumulative net creation is explained by 100 thousand new firms; 340 thousand firms that stopped reporting sales for three months or more; 230 thousand firms that, having exited for three months or more, resumed reporting sales since February, and 30 thousand that have a turnover that falls outside the above definitions.[6]/ This means that two out of every three companies that at some point stopped reporting sales for three months or more managed to recover during the year. It is also important to stress that the creation of new companies was only 10% lower than it was in the same months of 2018 (110 thousand firms).

Another relevant margin studied in our last Monetary Policy Report (Box IV.1 in the December 2020 issue) refers to the evolution of connections between firms and their suppliers. Said Report documented a significant drop in the number of these connections, raising some warnings regarding their possible effects on the efficiency of production chains and the economic recovery. Figure V.11 updates this analysis to December 2020, showing that, consistent with the recovery in the number of firms during the second half of the year, there was also an increase in the number of connections between firms and suppliers, returning to pre-pandemic levels.

[5]/ Strictly speaking, a fourth component must be added that corresponds to non-allocated turnover of firms. See note to Figure V.10 for more detail.

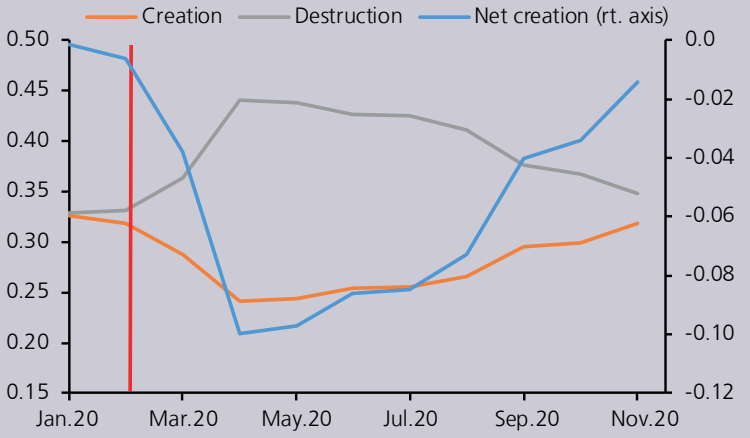
[6]/ It is worth mentioning that the re-entries observed since February also include companies that stopped reporting sales for three or more months prior to February, and therefore includes the re-entry of companies that, for example, stopped reporting after the social outbreak. The unallocated turnover corresponds to firms that returned to reporting between March and April but had stopped reporting for only one or two months, and subtracts firms that, having stopped reporting in November or December 2020, returned to reporting in January 2021.

FIGURE V.10 BREAKDOWN OF NET ENTRY OF FIRMS IN CHILE DURING 2020 (*)
(thousands)



(*) Net entries calculated as the difference in the number of firms in each month from March to December 2020, with respect to figure of February 2020. As an example, the last bar shows the difference between December and February, equivalent to 20,455 firms. This in turn is broken down into four components as follows: exits are subtracted from new entries (green bar, 100,620) are subtracted from company exit (red bar, 341.572), and re-entries are added (yellow bar, 229.321). Exits include firms that stop reporting sales between March and December for which it is known, with information up to January 2021, that they did not report for 3 or more consecutive months (except for those that stopped reporting in December, in which case they would stop reporting for only two months). For re-entry, two types of firms are considered: those that re-entered between June and December, having stopped reporting sometime since March for 3 or more consecutive months, and those that, having stopped reporting from before March for 3 or more consecutive months, they did it again sometime between March and December. The fourth and last component is the non-allocated turnover (NAT, gray bar, 32,086) which, for consistency with the net inflow, adds together firms that reported again between March and April, but having stopped reporting for only one or two months. and subtracts firms that, having stopped reporting in November or December, resume reporting in January 2021.
Source: Central Bank of Chile based on form F29 of the Internal Revenue Service (SII).

FIGURE V.11 CREATION AND DESTRUCTION OF RELATIONSHIPS WITH SUPPLIERS (*)
(annual change, percent)



(*) Documents gross creation and destruction (left axis) and the creation (right axis) of productive relationships of firms with their suppliers, expressed in year-on- year growth. Firms belonging to the National Accounts Directory are included, except those linked to EGW and Public Administration. Red vertical line marks February 2020.
Source: Central Bank of Chile based on digital invoicing data.

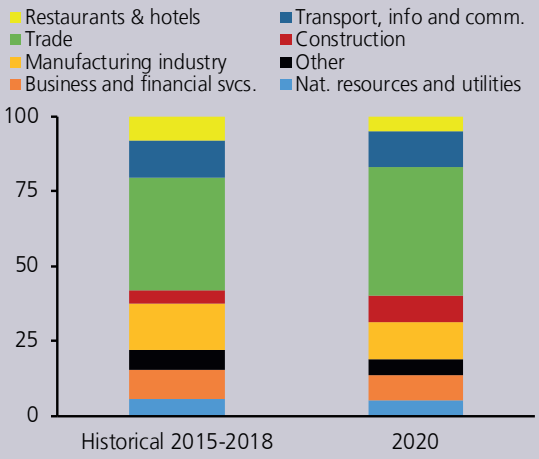
Characteristics of entrant firms during the Covid-19 crisis

A relevant question is what are the characteristics of the new businesses created during the crisis. For example, if they show a significant sectoral bias, which could be indicative of structural changes that imply challenges and adjustment costs in the short term; in particular, to the extent that they require adjusting competencies in the labor market. Moreover, if they are smaller in size, or if there is a lower intensity of worker hiring compared to historical patterns, the positive impact of the new companies created would be partially mitigated.

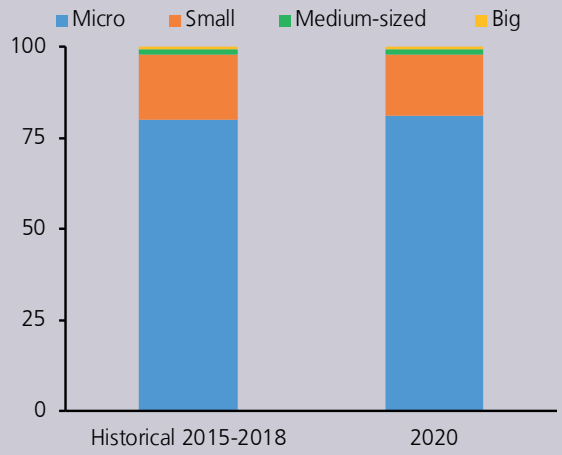
Panel (a) of figure V.12 shows the distribution by sector of new firms. Panel (b) does so by size, according to four strata, using for comparison a history of new firms between 2015 and 2018. The patterns do not differ much from previous years, beyond some higher intensity of creation observed in Trade and Construction, and a somewhat lower intensity in Manufacturing, Restaurants & Hotels and Business Services. There is also no significant change in the distribution by size. In addition, new firms show hiring levels comparable to previous years. Thus, the average number of jobs is close to three workers per company —around seven if firms with two or more workers since their inception are considered—, which is in line with previous years.

FIGURE V.12 CHARACTERISTICS OF NEW FIRMS (*)
(percent of total new firms)

(a) By economic sector



(b) By size



(*) Panel a: percentage share of each sector in the distribution of entrant firms. Panel b: percentage share of each stratum in the distribution of entrant firms. Big: sales of over 100,000 UFs; Medium-sized: sales between 25,000 and 100,000 UFs; Small: sales between 2,400 and 25,000 UFs; Micro: sales below 2,400 UF.
Source: Central Bank of Chile based on form F29 of the Internal Revenue Service (SII).

Conclusions

The pandemic had a major impact on the dynamics of businesses coming and going during 2020. After falling sharply in the first half of the 2020, the net entry of firms recovered strongly towards the end of the year. This result was mainly explained by the recovery of firms that at some point stopped reporting sales for extended periods of time, but also by a significant recovery in the creation of new firms. The characteristics of the latter are similar to those of previous years, in terms of their sectoral composition, size and hiring intensity. This recovery is also visible in the connections between companies and their suppliers.

Although this evidence does not complete the analysis of the scars left by the pandemic —which will have to evaluate more in-depth factors such as increased indebtedness and the still partial recovery of employment in the firms that managed to survive the crisis, among many others—, the survival of companies during the pandemic and the recovery in the dynamics of creation are undoubtedly good news. This also helps to explain the faster recovery of activity in the latter part of 2020. The Central Bank will continue to contribute to the understanding of relevant macroeconomic phenomena based on the growing analytical possibilities opened up by the availability of microdata.

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