Tuesday, 8 November 2022

Financial Policy Meeting – second half 2022

At its second Financial Policy Meeting, the Board of the Central Bank of Chile decided not to activate the Counter-cyclical Capital Buffer. The decision was adopted by the unanimous vote of its members. It was considered that, despite some vulnerabilities in some specific sectors and a more complex international environment, the systemic risk analysis shows that the banking sector has sufficient buffers to withstand stress scenarios.

The Financial Policy Meeting is the instance in which the Board of the Central Bank of Chile decides on the Countercyclical Capital Buffer (CCyB). This is a faculty of the Bank as established in Article 66 ter of the General Banking Law and is framed within the new Basel III capital standards for the banking system.

The CCyB is a macroprudential requirement for the banking system, whose objective is to enhance its resilience to severe stress scenarios, resulting from risks of a systemic nature.

Regarding the background information that the Board had available on this occasion, it is worth noting that, globally, a scenario has been consolidated in which monetary policy has become more contractionary, in the face of higher and more persistent inflation. Risk appetite has decreased and the US dollar has strengthened. Growth prospects have deteriorated, increasing the likelihood that developed economies will experience a recession next year. Financial conditions for emerging economies have worsened. All this occurs against a backdrop of reduced liquidity in the face of continued high global uncertainty. A further deterioration of the external scenario is perceived as the greatest threat to global financial stability, which could especially affect the financing of emerging economies such as Chile.

At home, the economy has already begun the process of adjusting the imbalances it accumulated in 2021. Throughout this phase of the cycle, the gap will narrow and will gradually move towards negative levels. In addition, spending and economic activity will decline, while inflation will fall from its current highs to values compatible with the 3% target. Monetary policy has adopted a contractionary stance in line with this scenario. All in all, the current account deficit remains high, with a shallower capital market, which lessens the economy's ability to accommodate financial pressures from abroad. This is reflected in the high volatility of the exchange rate and long-term interest rates. The cost of foreign currency financing has increased in the most recent period.

The real-estate market has undergone a significant adjustment in the past few months, with significant cost increases, weak demand and greater financing restrictions. All this has been reflected in the financial difficulties of some construction and real-estate companies. The prudent management of this exposure by the banks has prevented this from representing systemic vulnerability at this point in time.

Regarding bank credit, third quarter data posted negative growth. The ratio of credit to GDP remains below its historical trend and no significant rebound is foreseen in the short term. The Bank Lending Survey shows that supply remains constrained and demand is perceived to have weakened.

The stress tests of the banking system presented in the Financial Stability Report conclude that the banking system has sufficient provisions and capital to confront a severe stress scenario. Nonetheless, it is necessary for banks to continue adapting their solvency levels in order to converge to Basel III standards.

In conclusion, the analysis performed indicates that it is not necessary to activate the Countercyclical Capital Buffer.

The minutes of this Financial Policy Meeting will be published at 8:30 hours of Wednesday, 23 November. The next Financial Policy Meeting will be held on 22-23 May 2023 and the statement thereof will be released at 18:00 hours of the second day.