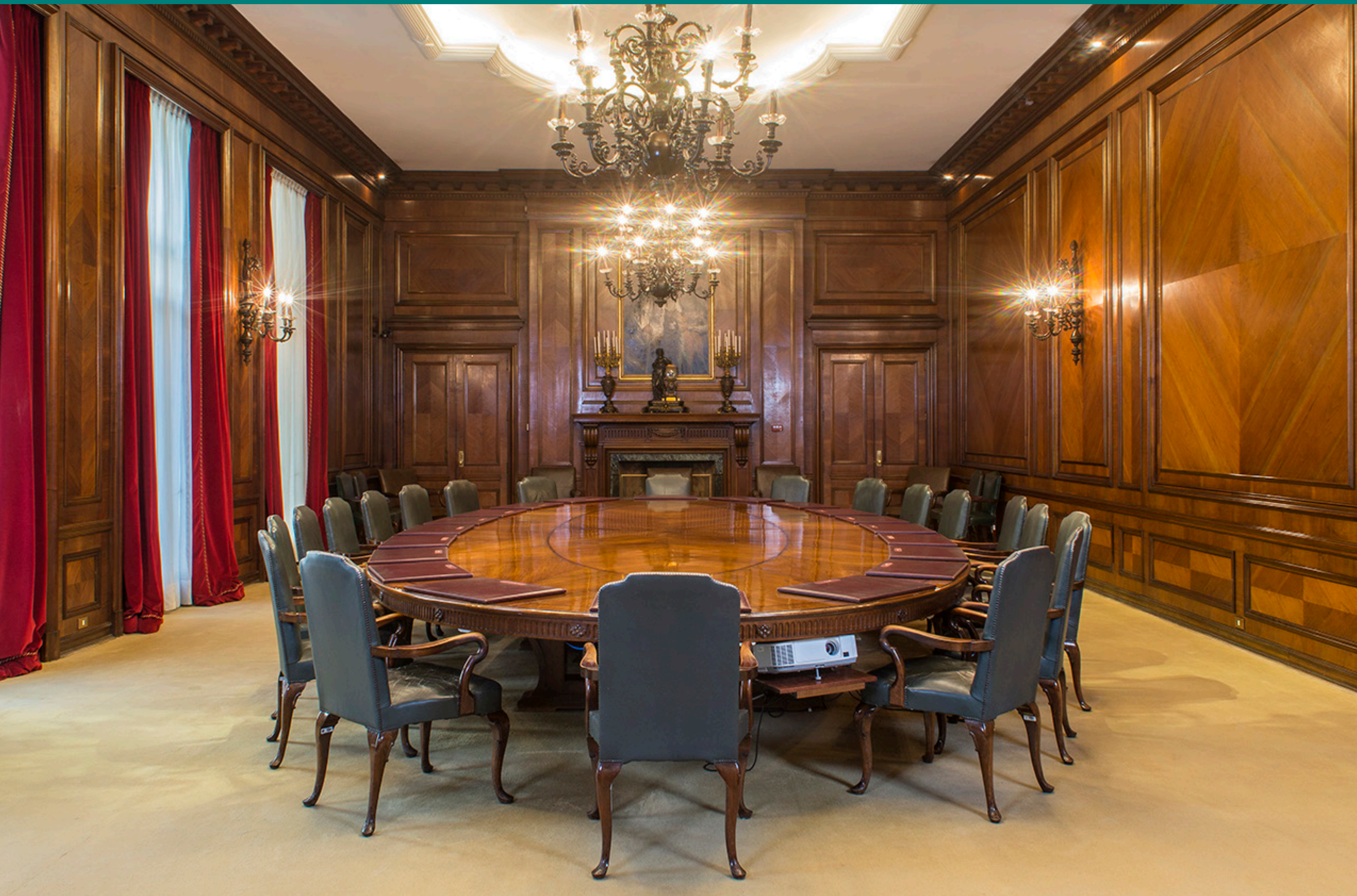
MONETARY POLICY MEETING

MAY 2022



FINANCIAL POLICY MEETING

Minutes of the financial policy meeting No. 1, held on 16-17 May 2022.

Present: Rosanna Costa, Governor; Pablo García, Vice-Governor; Alberto Naudon, Board member; Luis Felipe Céspedes, Board member; Stepanka Novy Kafka, Board member.

Also present: Beltrán de Ramón, General Manager; Juan Pablo Araya, Legal Counsel and Attestor; Elías Albagli, Monetary Policy Division Director; Paulina Yazigi, Financial Markets Division Director; Rodrigo Alfaro, acting Financial Policy Division Director; Gloria Peña, Statistics Division Director; Michel Moure, Institutional Affairs Division Director; Diego Ballivián, Corporate Risk Division Director; Juan Francisco Martínez, Financial Stability Manager; Gabriel Aparici, Financial Infrastructure and Regulation Manager; Markus Kirchner, Macroeconomic Analysis Manager; Enrique Orellana, Monetary Policy Strategy and Communication Manager; Miguel Fuentes, International Analysis Manager; Diego Gianelli, Market Operations Manager; Juan Carlos Piantini, Business Strategic Administration Manager; Sofía Bauducco, acting Economic Research Manager; Francisco Ruiz, Macroeconomic Statistics Manager; Alejandro Puente, Advisor to the Finance Minister; Solange Berstein, President of the Financial Market Commission; Nancy Silva, General Director of Research, Statistics, and Data of the Financial Market Commission; Gabriela Gurovich, Head of the Financial Analysis Department; Andrés Alegría, senior economist of the Financial Analysis Department; Marlys Pabst, Secretary General.

The Financial Policy Meeting is the instance in which the Board of the Central Bank of Chile decides on the Countercyclical Capital Buffer (CCyB) within the framework of the new Basel III capital standards for banks, in accordance with the provisions of Article 66 ter of the General Banking Law. The CCyB is a macro-prudential requirement for the banking system aimed at increasing the system's resilience to severe stress scenarios resulting from systemic risks.

1.Background

a.The international scenario

Financial conditions had tightened around the world. Inflation was showing widespread acceleration globally and signs of increasing persistence, which had prompted an accelerated withdrawal of monetary stimulus in a number of economies. The prolonged conflict in Europe and the problems arising from the new mobility restrictions in China added further pressures to inflation and heightened global uncertainty. The global growth outlook had been reduced accordingly.

Risk appetite was declining and financial assets presented a considerable correction. It was expected that international developments would not provide a boost to local bank credit and could even pose a significant downside risk.

b.The local scenario

The local economy had begun to slow down, after its strong expansion during 2021. It is worth noting that this dynamic had not been accompanied by an expansion of the banking credit cycle.

High inflationary figures had been recorded as a consequence of an expansionary cycle driven by excessive domestic spending, compounded by strong cost pressures and a depreciated exchange rate above its fundamentals, owing partly to high local uncertainty.

According to the Bank Credit Survey, the slowdown in bank lending during the first quarter of this year reflected both lower demand and tighter supply conditions, although there was a recent increase in rolling credit. Non-performing loans remained low by historical standards, although increases were observed in some specific sectors. In this context, banks have maintained a precautionary behavior by increasing provisions. Meanwhile, shorter-term interest rates have begun to factor in the increases in the monetary policy interest rate (MPR).

2.Analysis of vulnerabilities, risks, and mitigators

The credit to GDP and to the Imacec gaps were below their long-term trend. A simple exercise, based on the central scenario of the March 2022 Monetary Policy Report and historical elasticities between credit and output, estimated that the credit to GDP gap would remain aligned over the next three years.

With respect to households and firms, several financial indicators had partially closed the misalignments observed during the pandemic, showing lower vulnerabilities of these agents. This was also the case of macroeconomic variables, with the exception of the current account.

The banking sector had sufficient capital levels to withstand the impact of severe economic scenarios, as inferred from the stress tests applied. This was so thanks to a high level of provisions from a historical perspective relative to low levels of delinquency, and an adequate solvency and liquidity position. It was estimated that this would be strengthened along with the convergence to Basel III standards.

3.Options analysis

All the Board members agreed that the expected benefits should be weighed against the costs that would be incurred in the event of a CCyB activation. They stressed that the accumulation of capital to face cyclical adverse shocks allowed building a buffer that reduced the probability of a systemic crisis. They noted, however, that the CCyB could deepen contractionary periods. In addition, the Board thought it pertinent to make further progress in quantifying the economic effects of this buffer and its interaction with monetary policy. They also mentioned the distinction between the nature of the CCyB and the conservation buffer, pointing out that the latter responded to shocks in normal times, while the former was triggered by cyclical shocks. Therefore, they noted that these elements constituted an additional dimension of coordination with the Financial Market Commission (FMC).

One Board member suggested complementing the lending gap analysis by considering the total level of indebtedness of the economy, taking into account idiosyncratic elements of the local financial market and identifying whether the sources of financing are internal or external, short or long term. Regarding this same topic, the Board members added that the credit cycle indicators could contain distortions derived from the pandemic period that needed to be addressed. First, GDP growth had shown greater variability in the face of a number of factors and special measures implemented. Second, consumption had been driven by the liquidation of pension savings and not necessarily by increased debt.

The Board members pointed out that in order to initiate a capital accumulation phase, certain conditions had to be in place, which was not the case at the moment. One such condition consisted of high risk-taking and asset valuations misaligned with their fundamentals. Another was that credit borrowers and lenders were perceived to be underestimating the probability of adverse future scenarios, where excess optimism would be captured via financial indicators.

The full Board agreed that the background information presented did not justify activating the CCyB. Although the country had faced an expansionary business cycle in 2021, it had not been characterized as credit-driven. Moreover, banks would not require additional capital, as analyzed in the bank stress tests described in the Financial Stability Report. Also noted was that the existence of global risks and uncertainty did not generate per se the necessity to increase the CCyB for banks in Chile and that there were no signs of excessive risk-taking by the domestic banking system.

4. Financial policy decision

Governor Costa, Vice-Governor García, and Board members Naudon, Céspedes, and Novy voted against activating the Countercyclical Capital Buffer. They also agreed to notify the Financial Market Commission of the decision.

banco central Chile