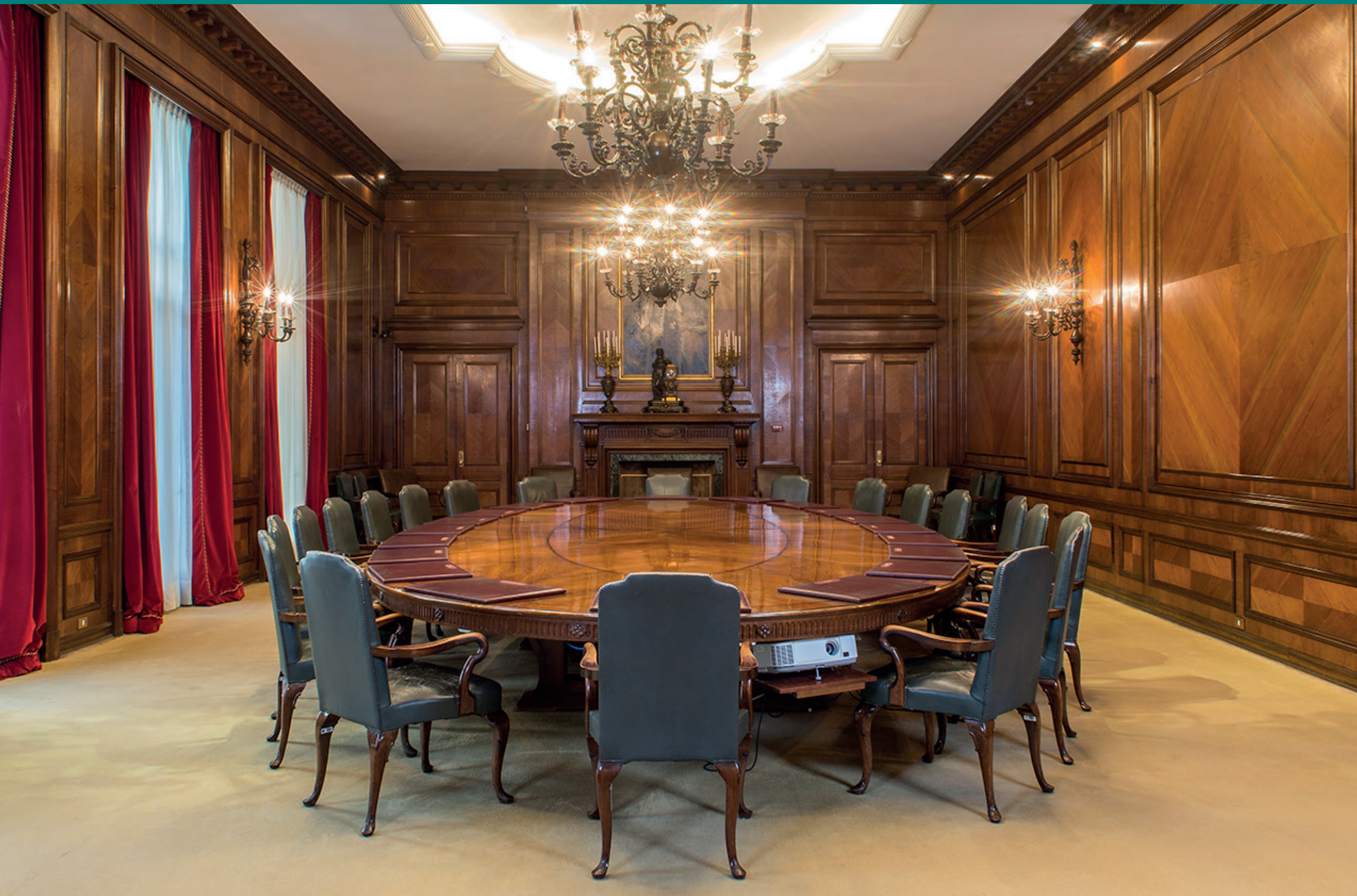
banco central Chile

MONETARY POLICY MEETING

NOVEMBER 2022



MONETARY POLICY MEETING

Minutes of the financial policy meeting No. 2, held on 7 November 2022.

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

The meeting was also attended by the General Manager, Beltrán de Ramón; General Counsel, Juan Pablo Araya; Monetary Policy Division Director (deputy), Markus Kirchner; Financial Markets Division Director (deputy), Juan Carlos Piantini; Financial Policy Division Director, Rosario Celedón; Statistics Division Director, Gloria Peña; Institutional Affairs Division Director, Michel Moure; Corporate Risk Division Director, Diego Ballivián; International Analysis Manager, Miguel Fuentes; Monetary Policy Strategy and Communication Manager, Enrique Orellana; Economic Research Manager, Sofía Bauducco; Market Operations Manager (interim), Felipe Musa; Financial Stability Manager, Juan Francisco Martínez; Financial Infrastructure and Regulation Manager, Gabriel Aparici; Financial Research Manager, Rodrigo Alfaro; Macroeconomic Statistics Manager, Francisco Ruiz; Communications Manager, Felipe Lozano; Chair of the Financial Market Commission, Solange Berstein; General Director of Research, Statistics, and Data of the Financial Market Commission, Nancy Silva; Advisor to the Finance Minister, Alejandro Puente; Financial Analysis Department Manager, Andrés Sagner; Macrofinancial Modeling Department Manager, Mauricio Calani; Senior Economist of the Financial Analysis Department, Andrés Alegría; and General Secretary, Marlys Pabst.

The Financial Policy Meeting (FPM) is the meeting at which the Board of the Central Bank of Chile determines the Countercyclical Capital Buffer (CCyB). The Bank is granted this authority under the provisions of Article 66 ter of the General Banking Law, in the framework of the new Basel III capital standards for the banking industry.

The CCyB is a macroprudential requirement for the banking system, whose objective is to increase the system's resilience in the face of severe stress scenarios deriving from systemic risks.

1. Background

a. International scenario

The outlook for the international scenario had become more negative. The risk of a significant worsening of external financial conditions had increased, due to a combination of monetary adjustments at the global level and various sources of vulnerability.

High and persistent inflation around the world had brought monetary policy into restrictive territory at the global level, due in part to repercussions of the conflict between Russia and Ukraine in terms of energy and commodity prices. The dollar had strengthened, and the risk appetite had decreased. Thus, financial conditions continued to worsen for the developed countries, which subsequently affected the emerging economies.

Additionally, the largest economies continued to experience financial vulnerabilities. The real estate sector had weakened substantially in the developed countries, and there were concerns about high corporate debt. The Chinese economy was also undergoing a downturn in the real estate sector and in its growth outlook. The emerging economies, in turn, faced an increase in the cost of refinancing their public debt, after increasing their leverage during the pandemic. Fixed-income liquidity was low in various financial markets. The world growth outlook continued to deteriorate, and surveys showed an increased probability that the developed economies would enter a recession in 2023.

In this context, developments at the international level were expected to provide a negative stimulus to economic activity and credit growth for the world in general and Chile in particular.

b. Local scenario

The local economy had begun to correct the internal imbalances accumulated in 2021. This was reflected in variables such as the spending gap, inflation, and the current account deficit, which remained high. The Board had implemented a restrictive monetary policy rate (MPR) and planned to hold it at this level for as long as necessary to ensure inflation convergence. In any event, the Chilean economy was faced with a complex scenario, with particularly high risks in the external environment.

Locally, foreign currency funding costs had increased in the face of tighter conditions in the United States and expectations of a more aggressive response by the U.S. Federal Reserve. However, long rates in UF had increased less than in comparable economies. In this context, bank lending was undergoing a contraction. Default indicators remained low for bank portfolios, although there was a perceptible deterioration in the financial situation of the corporate sector, particularly in certain sectors such as real estate and construction.

2. Analysis of vulnerabilities, risks, and mitigators

The November FPM was held in a context of a strengthening dollar and a significant increase in some international risks. Thus, a worsening of the international scenario had become the main source of risk for financial stability at the world level. There were also some warning signs in terms of liquidity and volatility in some markets, such as the sovereign fixed-income market.

Domestically, exchange rates and, to a lesser extent, long-term interest rates continued to record high volatility. At that time, the adjustment of the real estate and construction sectors did not represent a systemic vulnerability, despite ongoing concerns for the evolution of this process.

The credit gap—defined as the cyclical component of the credit-to-GDP ratio—remained below its historical trend, and estimates indicated that this would not change in the short term. In this line, the Bank Lending Survey for the third quarter pointed to tight supply and a perception of weak demand.

Although the risk map revealed vulnerability in some sectors, it was not systemic in nature. Moreover, stress tests showed that the banking sector was resilient under a severe stress scenario, due to the maintenance of high capital buffers and prudent lending and provisioning practices.

Finally, macrofinancial model simulations generated scenarios characterized by less dynamic lending, consistent with the economic forecasts.

3. Analysis of options

The Board Members analyzed the set of background information and other evidence presented at the Meeting. They agreed that the most significant risks for the local economy derived from a more deteriorated external scenario, whereas the local risks were considered to be isolated or specific, as opposed to systemic.

One Board Member considered that applying the CCyB would be inconsistent in the context of a pause in the upward cycle of the monetary policy rate. Another Board Member suggested that while the international banking sector remained resilient according to the background information presented, there could be external risks from the nonbank financial system, so it was important to continue analyzing possible systemic vulnerabilities originating in this sector.

All the Board Members agreed that the information presented, including the analysis of the credit gap, systemic risk maps, and the stress test results, did not justify the activation of the CCyB. In particular, the stress test results for the local banking sector, which would be presented in the Financial Stability Report, showed that the sector had sufficient capital to face severe stress events during the Basel III convergence process.

It was argued that there were no apparent benefits to activating the buffer and expanding the banking sector's capital base in this phase of the economic cycle, given that the economy was going through a slowdown, while the MPR was high and the credit cycle was not above the output cycle. Finally, the Board expressed its appreciation for the advances made on the analytical methodologies and the coordination efforts with the Financial Market Commission, and they agreed on the need to continue refining the implementation of the tool.

4. Financial Policy Decision

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

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