MONETARY POLICY MEETING

JANUARY 2023

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Minutes of the Monetary Policy Meeting No. 295, held on 25–26 January 2023.

Present the Finance Minister, Mario Marcel.

Also present: Beltrán de Ramón, General Manager; Mauricio Álvarez, acting Legal Counsel and Attestor; Elías Albagli, Monetary Policy Division Director; Juan Carlos Piantini, acting Financial Markets Division Director; Rosario Celedón, Financial Policy Division Director; Gloria Peña, Statistics Division Director; Michel Moure, Institutional Affairs Division Director; Diego Ballivián, Corporate Risk Division Director; Markus Kirchner, Macroeconomic Analysis Manager; Enrique Orellana, Monetary Policy Strategy and Communication Manager; Miguel Fuentes, International Analysis Manager; Sofía Bauducco, Economic Research Manager; Felipe Musa, Market Operations Manager; Juan Francisco Martínez, Financial Stability Manager; Francisco Ruiz, Macroeconomic Statistics Manager; Felipe Lozano, Communications Manager; Andrés Sansone, Advisor to the Finance Minister; Erika Arraño, Senior Economist; Marlys Pabst, Secretary General.

1. Background

The local scenario

In December 2022, headline and core annual inflation had been at 12.8% and 10.7%, respectively, both figures down from the previous month. However, inflation accumulated in the last two months had been higher than projected in the December Monetary Policy Report, both in its core and volatile components. Inflation expectations two years ahead from the Economic Expectations Survey (EES) and the Financial Traders Survey (FTS) persisted above 3%. In the latter, although two-year expected inflation was lower than in the survey prior to the December meeting, it showed a slight rise in the latest observation.

Cost pressures had shown some signs of moderation but were still high. Companies' cost expectations (IMCE) had continued to decline across all sectors. Transportation costs and the prices of energy and foodstuffs had continued to normalize globally. Furthermore, the exchange rate had fallen nearly 10% in the past few weeks.

In November, the non-mining Imacec had declined again, with a 0.2% fall in monthly deseasonalized terms (-0,8% for the total Imacec). This result exceeded the forecast of the December Report and was explained to some extent by some services and wholesale and retail trade. However, this had been partly offset by a greater relapse of the manufacturing industry due to some particular factors, such as maintenance downtime in refineries and a truck drivers' strike. From the expenditure side, the adjustments in consumption- and investment-related high-frequency indicators continued, including retail trade, imports, and low construction activity.

In the labor market, both employment and participation figures had seen no big changes, with the unemployment rate hovering around 8%. Real wages continued to falter, in a context of still low demand for workers: the Internet Job postings index was under its historical average and companies hiring expectations (IMCE) remained low, amid persistent pessimism among consumers (IPEC) and entrepreneurs (IMCE).

The local financial market mirrored the global trends. With respect to the latest Meeting, the IPSA stock index and long-term interest rates were at similar levels, while the exchange rate had appreciated around 8%, somewhat more than comparable currencies.

Real banking loans remained contained. Commercial and consumer portfolios continued to fall (-4.6 and -2.1%, respectively in annual terms), while housing loans continued to show record-low annual changes. Consumer and commercial credit interest rates remained above their historical averages, with respective increases up to 28.1 and 15.3%. Interest rates on UF-indexed mortgage loans had dropped from November, to 4.4%, in a context where the Bank Lending Survey for the fourth quarter reflected still stringent supply conditions and further falling demand.

The various market expectations indicators placed the monetary policy rate (MPR) at 11.25% at the January Meeting and the next cut in April. Forecast ranges obtained from the surveys had declined to 6.5%-7% in one year and to 4.5%-4.75% in two years. Expectations inferred from financial asset prices had also fallen and were below those contained in the surveys.

The international scenario

Internationally, inflation had declined, especially in the U.S., where the CPI had gone from 8.2% to 6.5% between September and December 2022, owing mainly to lower energy prices. In any case, global inflation was still high, as the persistence of the core data continued to indicate, and inflationary pressures remained quite significant. In this scenario, the main central banks had continued to raise their benchmark interest rates. At its December Meeting, the U.S. Federal Reserve (Fed) had raised range of the fed funds rate by 50 basis points (bp), to 4.25%-4.5%, in the context of a still tight labor market, which continued to pose an important upward risk for inflation. In turn, the European Central Bank had raised its monetary policy rate by 50bp at its last meeting, and had intensified the restrictive tone of its statement, adding a significant increase in its inflation forecasts. In Latin America, inflation seemed to have reached its peak in most countries, and some central banks had continued to raise their benchmark rates. Brazil, where the rate had been maintained, did not rule out resuming rate hikes if so required.

The global growth outlook for 2023 remained weak, despite a small upward adjustment. In the U.S., incoming data showed that activity was still resilient, with robust private consumption indicators, supported by the momentum that the labor market continued to provide, as well as the dynamics of saving and credit. In China, the outlook had improved significantly following the end of the zero-Covid policy in December. The most recent activity and spending data had brought positive surprises, while measures to support its real-estate sector seemed to have reduced the likelihood of a severe contraction in the near future.

The Eurozone also seemed to have outperformed expectations, as the effects of the energy crisis had been mitigated partly by the resilience of low energy-intensive industries, fiscal aid programs, and more favorable climate conditions. In addition, the end of China's confinements was expected to boost external demand, while the outlook for gas prices had improved. Against this backdrop, the region's confidence indicators had seen some marginal improvement.

Financial markets had reflected greater optimism, fueled largely by changes in China's zero-Covid policy and prospects of a more relaxed monetary policy path by the Fed, in a context where tighter monetary policies were expected from the European Central Bank and the Bank of Japan. Since the last meeting, the dollar had depreciated against all other currencies, risk appetite and capital flows to emerging economies had increased, and sovereign and corporate financing spreads in general had evolved more favorably recently. With the important exception of the U.S., most stock markets had risen, further encouraged by the more positive outlook for global growth. Long-term interest rates had shown mixed movements.

Commodity prices had behaved heterogeneously. The copper price had risen significantly, up to US$4.2 per pound (+11% since the last Meeting), driven by better demand prospects from China and in a context of persistently tight supply. Oil was trading around US$83 per barrel (+5% since the last Meeting for the WTI-Brent average).

2. Background analysis and discussion

The discussion covered the external scenario, noting that, since the December MP Report, it looked somewhat more favorable, with increased risk appetite in global financial markets. In the U.S., recent inflation data had surprised to the downside, encouraging market expectations that disinflation could occur sooner and have a milder impact on activity and employment. This had led the market to anticipate a less contractionary monetary policy path. In China, the end of the zero-Covid policy spurred expectations of higher global spending and activity, increasing the price of commodities, especially metals, including copper. It was further noted that, in any case, the risks of the global scenario remained significant. The gap between the fed funds rate as expected by the markets and by the Fed remained, which could be a source of global volatility when resolved.

These external trends had been picked up by the local financial market, notably the appreciation of the peso, which placed the exchange rate well below its level at the statistical cutoff of the December Report. It was mentioned that, while the stronger peso was a significant development, an important factor to assess its macroeconomic implications —and its persistence— was to understand the reasons behind it. On one hand, said appreciation could be attributed to greater optimism regarding the evolution of emerging economies, associated with the change in China's zero-Covid policy, which would put upward pressure on commodity prices and generate greater demand for Chilean exports. This would improve the current account of the balance of payments. In the medium term, such a scenario could even generate greater inflationary pressures, despite having a disinflationary effect in the short term. On the other hand, the drop in the exchange rate could be due to the predominance of purely financial phenomena of lower risk premiums and shorter-term capital flows. In such case, there was the benefit of a better immediate financial tone and disinflationary pressures, but it did not guarantee higher growth going forward. Finally, it was also possible that the decline in the exchange rate was a response to an unfolding sense that the cyclical weakness and disinflationary process in the U.S. was proceeding at a much faster pace. That situation —where the U.S. economy was not performing as well as expected and the Fed was aggressively cutting interest rates— would be a relatively disinflationary medium-term scenario for Chile. However, there was agreement that at this point it was difficult to elucidate the macroeconomic impacts of the peso appreciation, including its effect on inflation, and that was a task to be addressed with more information in the next Report.

On the domestic front, it was noted that activity figures had presented some upward surprises in recent months. In any case, they were rather specific and limited, so that, in general, the adjustment scenario contemplated in the Report was coming true. High-frequency information indicated that the adjustment was ongoing, particularly in private consumption. In investment, survey information (CBC), capital goods imports and expectations continued to suggest that, beyond the positive surprise of the third quarter, investment would be adjusting downwards. In the labor market, real wages and vacancies continued to dwindle.

Regarding inflation, there was consensus that, despite having decreased since its August peak, it was still very high. Moreover, the annual variation of its core part showed no major changes in recent months, so the drop in total inflation was rather associated with its volatile component. It was further noted that inflation accumulated in November and December had exceeded somewhat the Monetary Policy Report's forecasts for both volatile and core inflation. It was worth noting that the short-term inflation projections measured in surveys showed no significant variations, despite the substantial appreciation of the peso. Some measures, such as two-year expected inflation in the FTS, even showed a slight increase. In this context, two-year inflation expectations remained above 3%.

3. Analysis of monetary policy options

The Board recalled that in the latest Meeting they had delivered an unequivocal message regarding the future evolution of the monetary policy rate. That is, the MPR would be kept at 11.25% until the state of the economy informed that the convergence of inflation to 3% was consolidated.

Therefore, in the Board's opinion, what had to be done was to analyze whether there were any clear signs of said process being consolidated. Although establishing such a conclusion required reviewing multiple dimensions, some of them could be mentioned. On one hand, broadly speaking, the macroeconomic scenario was aligning itself with the assumptions in the December Report. Some aspects stood out, however. Although limited, activity and inflation brought some upward surprises which, coupled with the more positive tone of the external scenario, spurred some concerns about the speed of the economic adjustment and its implications for the convergence of inflation. The close of the 2022 National Accounts, which would be released in March, would give valuable information to assess the state of the adjustment the economy required to bring down inflation. On the other hand, the exchange rate was the most surprising variable but, as had been discussed, its medium-term implications on inflation were far from evident. Moreover, the markets' inflation expectations had not had a strong reaction to the appreciated peso, as expectations two years ahead persisted above 3%. Plus, the risks around the inflationary scenario were still important, with a marked asymmetry with its costs in case inflation did increase.

In this context, all five Board members agreed that there was no reason to believe that the convergence of inflation to the 3% target was consolidated. Therefore, the only plausible option was to keep the MPR at 11.25%.

One Board member pointed out that analyzing the option of making a small reduction to the MPR at this Meeting could be valid. In this Board member's view, this could be justified if it was kept in mind that, including the peso appreciation, the trends suggested that inflation was set to decline going forward, although it was recognized that there was not enough information. It could also be considered that, once deflated by inflation expectations one year ahead, the level of the MPR achieved 6% and was high by international standards.

The other members reaffirmed that, for the time being, the option of lowering the MPR was not a valid one. In their view, in the current scenario, the convergence of inflation relied significantly on the credibility of the Central Bank's capacity and commitment with the 3% inflation target over the two-year horizon. Any doubt would lead to an adjustment much more costly for the economy. The best way to mitigate this risk was to be more cautious regarding the start of the MPR reduction process. This suggested waiting until the process of inflation convergence to 3% was consolidated, because other paths could risk pausing or even reversing the process of lowering the MPR.

4. Monetary policy decision

Governor Costa, Vice-Governor García and Board members Naudon, Céspedes, and Novy voted to hold the MPR at 11.25%.

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