BOX I.1:

International financial conditions: macroeconomic impact

The massive withdrawal of monetary stimulus in the U.S. and the Eurozone has been identified as a potential source of stress for the global financial system by many observers, including mentions in several MP Reports. This is so because prolonged periods of near-zero rates and abundant liquidity encourage leverage by various agents and tends to increase risk-taking in credit markets. Indeed, during 2022, events in the United Kingdom and some banks in Europe pointed out these risks. Recent tensions in the U.S. and Eurozone banking systems are another expression of vulnerabilities in the current financial environment.[1]/ Although its outcome is still uncertain, the central scenario of this Report considers that this banking turmoil in developed economies will have negative consequences both internationally and at home. However, their effects are more limited than have been observed in past episodes of stress in the financial markets, such as the 2007-2008 financial crisis.

Lower credit growth is one of the central mechanisms through which economic activity will suffer this time around. Prior to the onset of this episode, banks in both Europe and the U.S. were already declaring a significant tightening of lending standards (figure I.21), which anticipated a slowdown in growth that would contribute to the adjustment of activity required to contain inflationary pressures.[2]/ Most recently, there has been a noticeable deterioration in several factors that determine bank credit. For one, the fall in the value of bank shares and the capital ratio (figure I.22), explained to a large extent by the increase in interest rates in the last year, tends to predict a slowdown in the dynamism of lending.[3]/ For another, in the U.S., increased uncertainty about the health of banks has intensified the outflow of bank deposits, especially from smaller institutions, which would also anticipate a more cautious behavior in the granting of credit. This is particularly relevant since these institutions, despite representing 30% of banking assets in the U.S., provide roughly 40% of total loans and close to 70% of commercial mortgage loans. The significant provision of liquidity by the Federal Reserve to contain tensions in the system, although it relieves short-term pressures on banks, does not eliminate the root of the problem, especially if credit quality also begins to be affected by the macroeconomic environment.

These financial tensions in developed economies in a context of a more restrictive monetary policy will be transmitted to emerging economies, including Chile, through several channels. On the one hand, the slower growth of activity in the developed world will dampen demand for exports. On the other, greater uncertainty in global markets will reduce risk appetite, thus widening financing spreads. Moreover, greater external uncertainty will affect consumer and business confidence in Chile, lowering the dynamism of spending and activity.[4]/

It is worth noting that the Chilean banking system presents important strengths, both in its development and in its regulation and supervision. The local banking business model is predominantly based on a traditional banking approach, with diversified financing, focused on granting credit, low share of investment assets and no significant maturity mismatches and with appropriate currency hedging. On the other hand, its regulation is in line with Basel III standards, being applied equally to all the banks in the market. There are periodic risk management and liquidity adequacy supervision processes carried out by the Financial Market Commission (CMF). This means that local banks are in a robust liquidity and capital position, which would allow them to appropriately withstand stress scenarios, as shown every six months in the Financial Stability Reports. There are also differences between Chilean monetary policy and those of developed economies, particularly the U.S. and Europe. Unlike the latter, in Chile the monetary adjustment process is sufficiently advanced, which offers more room to react to external shocks. Thus, complex situations in certain U.S. and European banks have not occurred in the Chilean case, given the strengths described above. In consideration of all this background, the Board concludes that Chilean banks are not a source of risk for the macroeconomic scenario.

[1]/ A more detailed account of the causes and evolution of the recent banking tensions can be found in Governor Rosanna Costa's presentation to the Senate Finance Committee on 23 March.

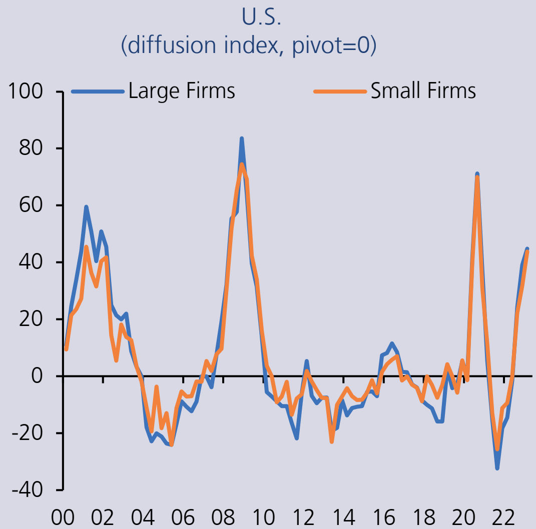
[2]/ Basset et al. (2014).

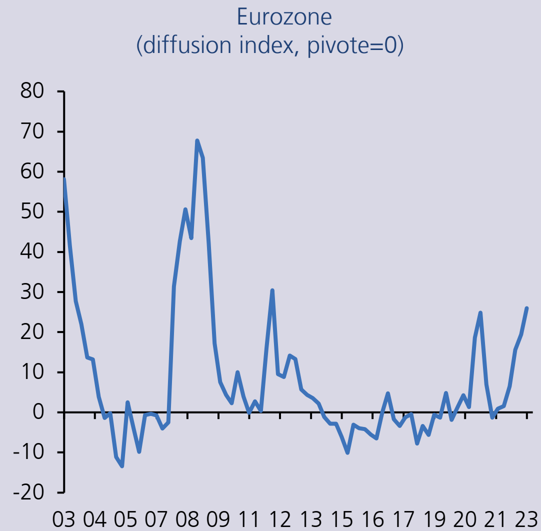
[3]/ See Girotti and Horny (2020); Boucinha et al. (2017); Kangiesser et al. (2017).

[4]/ Albagli and Luttini (2015) and Albagli et al. (2019) report on the influence of external factors in Chile's confidence indicators.

All in all, the evolution of the external scenario entails a high degree of uncertainty and occupies a central place in this Report. This is reflected, beyond its impact on the central scenario projections, in the construction of sensitivity and risk scenarios. In particular, the lower bound of the MPR corridor considers a scenario where external conditions worsen even further. It also considers a risk scenario where the magnitude of the problem resembles that observed in the Global Financial Crisis. Meanwhile, the upper bound considers, in addition to better fundamentals of the local economy, a more positive external scenario than depicted in the central scenario (chapter II).

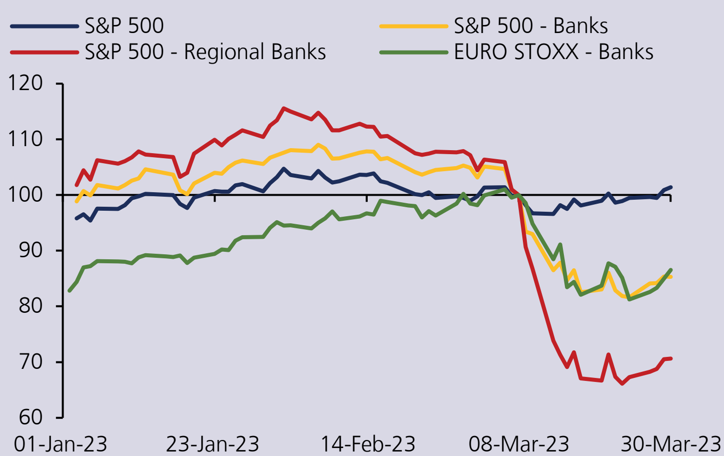
FIGURE I.21 LENDING STANDARDS FOR BUSINESSES





Sources: Fed and ECB.

FIGURE I.22 U.S. AND EUROZONE STOCK INDEXES
(index, 08.Mar.23=100)



Source: Bloomberg.