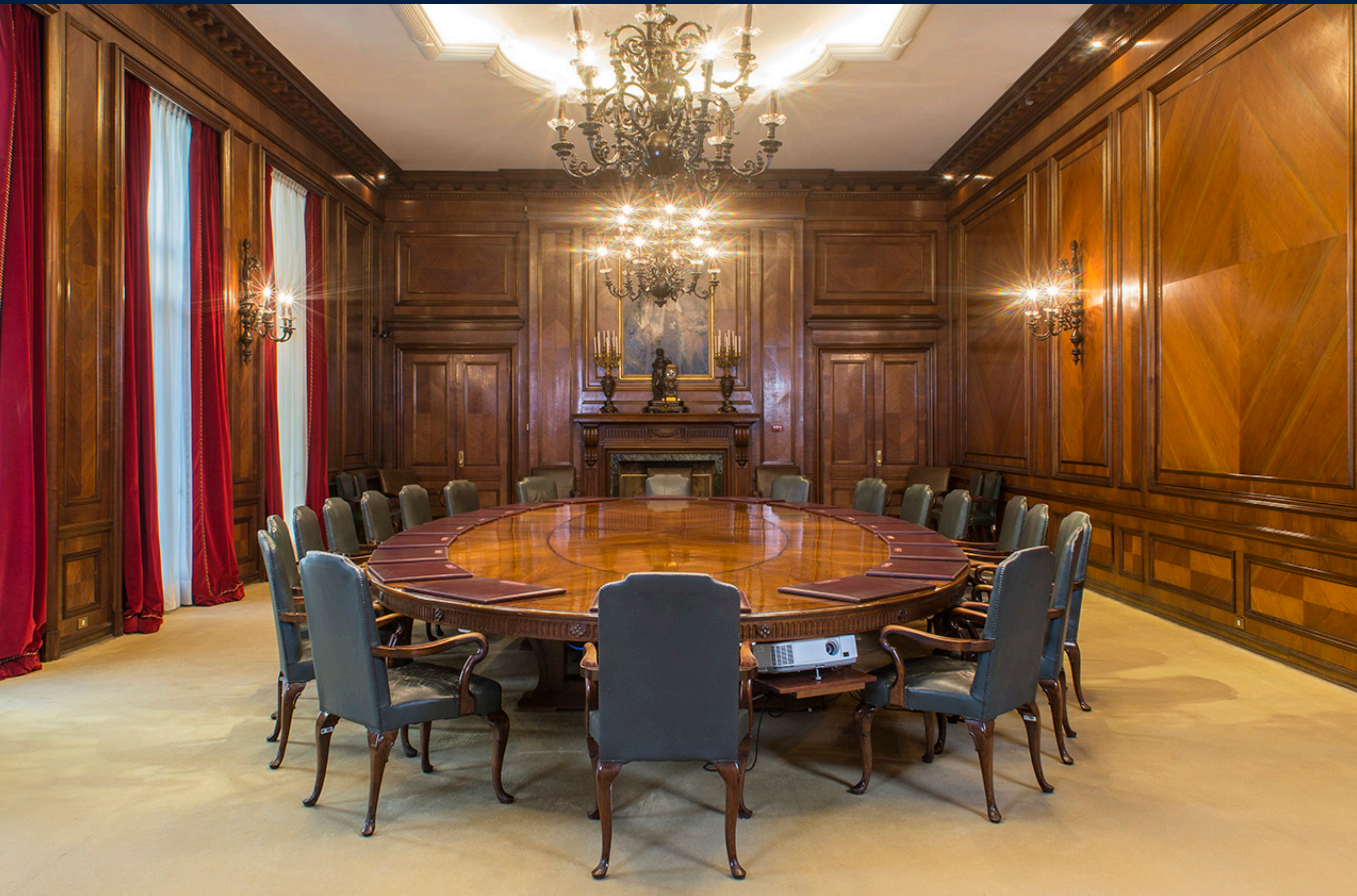
MONETARY POLICY MEETING

JUNE 2025



MONETARY POLICY MEETING

Monetary policy session No. 314, held on 17 June 2025.

Present: Rosanna Costa, Governor; Stepanka Novy, Vice-Governor; Alberto Naudon Board member; Luis Felipe Céspedes, Board member; Claudio Soto, Board member.

Present the Finance Minister, Mario Marcel.

Also present: Luis Óscar Herrera, General Manager; Juan Pablo Araya, Legal Counsel and Attestor; Elías Albagli, Monetary Policy Division Director; Felipe Musa, acting Financial Markets Division Director; Miguel Fuentes, acting Financial Policy Division Director; Francisco Ruiz, acting Statistics and Data Division Director; Michel Moure, Institutional Affairs Division Director; Markus Kirchner, Macroeconomic Analysis Manager; Enrique Orellana, Monetary Policy Strategy and Communication Manager; Sofía Bauducco, Economic Research Manager; Guillermo Carlomagno, International Analysis Manager; Rodrigo Wagner, Advisor to the Finance Minister; Marlys Pabst, Secretary General.

1. Background

The widespread increase in tariffs announced by the U.S. government in early April had resulted in major repercussions on the external scenario. This had entailed a considerable increase in world economic uncertainty, heightened by the escalation of the war in the Middle East days before the Meeting but had not been factored into the projections of the June Monetary Policy Report (IPoM).

The impact of trade tensions on world activity was expected to be negative. However, the changing course of the process made it difficult to assess its short-, medium- and long-term consequences. In any case, the reaction of global financial markets had not been the same as usual in the face of highly uncertain events, as the risk of U.S. assets compared to other economies, including Latin American ones had increased. Thus, long-term interest rate spreads vis-à-vis the United States had fallen in several economies, currencies had strengthened against the dollar and stock markets had risen. In Chile, as in other emerging economies, the impact of the trade conflict on activity had not been significant so far.

Locally, the inflationary outlook had evolved in line with expectations, and the upside risks to inflation that had arisen in the first months of the year, had moderated. The trajectory of core inflation --which excludes volatile items-- had been lower than anticipated. Two-year inflation expectations had been realigning with the 3% target. In turn, the cost shocks of previous quarters were not causing higher than estimated second-round effects.

Regarding activity, in the first quarter activity had been more dynamic than expected, part of which owed to specific elements in export sectors, for which incoming figures already showed a reversal. Another part was explained by greater dynamism in services. Domestic demand had increased further in line with forecasts. Private consumption had expanded in the first quarter, in the context of a mixed evolution of the main spending fundamentals. On the one hand, the levels of indebtedness and financial burden continued to fall, household expectations showed no big changes associated with the greater external uncertainty, and wages continued to show high rates of expansion, associated with recent legislative changes. On the other hand, the rise in labor costs was occurring while job creation was slow and the unemployment rate was rising.

Gross fixed capital formation (GFCF) had shown no progress in the first quarter, with persistent differences across sectors. However, leading indicators pointed to a stronger boost going forward. High-frequency data suggested that GFCF had recently performed more favorably, and the latest CBC large project survey showed a significantly greater investment amount budgeted for this and the next few years, particularly in mining and energy. This, in the context of improved financial conditions and where, according to several sources, the firms' expectations showed no evidence of significant impacts associated with international uncertainty.

Projections in the central scenario of the June IPoM were similar to those in the last two reports. Compared to December and March, activity now stood out for its relatively greater dynamism in the short term, while inflation did so for having moderated its upside risks and a similar time frame for its convergence to the target.

However, global risks had increased significantly. The tariff hike announced by the United States was unprecedented and of considerable magnitude. So far, the markets' reaction had been benign, with limited impact en households' and firms' economic perceptions, and with no substantial effects on the real economy. However, given the uncertain external scenario, a deterioration of external conditions and more severe negative impacts on the global economy could not be ruled out.

2. Background analysis and discussion

There was consensus that, between the March IPoM and the statistical close of the June IPoM (11 June), the main new development came from abroad, particularly from the U.S. trade policy announcements. It was noteworthy that, unlike other comparable episodes of higher risk aversion, financial markets had reacted with relative moderation. This was particularly visible in the behavior of emerging economies' asset prices, which had reacted positively and had not amplified the negative effects as they had on previous occasions. This, however, was not to say that these changes would not have an impact at the global level. On the contrary, while it was agreed that the main effect would be in the United States, it was also agreed that the rest of the world would be affected directly or indirectly. It was commented that, although the international scenario projections of the June IPoM did not show significant changes, this was so because an important adjustment had already been made in the March Report, and because of the benign reaction of financial markets.

Uncertainty had intensified in the days leading up to the Meeting with Israel's attack on Iran and its repercussions, raising global tension to levels not seen in years. At the time of the Meeting, it was a very recent development, about which there was no clarity as to its scope, development, or consequences, so actually it had not been considered in the IPoM's projections. In any case, it was clear that this event contributed to increasing global uncertainty and could negatively affect the world economy through different channels. For example, there could be a significant rise in the price of oil, which could lead to short-term inflationary pressures. On the other hand, this rise in oil prices could be accompanied by a deterioration in global financial conditions and in the economic expectations of agents across the board. In this case, although there would be a short-term inflationary shock, there would also be lower medium-term inflationary pressures, which should be weighed together as the conflict would evolve. Given its recent progression, it was not evident which of these channels would dominate. It was recalled that, being forward-looking, the monetary policy framework allowed for accommodating short-term inflationary shocks if medium-term forces pushed inflation in the opposite direction. This flexibility of the framework, however, should also take into account factors such as inflation persistence and the credibility of the inflation target.

On the domestic front, there was agreement that the economy showed a balanced position that was consistent with fairly limited changes in the projections of the IPoM's central scenario. Inflation had evolved in line with forecasts, even showing a somewhat faster decline in its core component. The upside risks raised in the first months of the year had moderated, which was an important development given the important role this factor had played in monetary policy decisions at previous meetings. In addition, the economy had grown more than expected at the beginning of the year, but the medium-term scenario in which activity would evolve around its trend in the coming quarters remained unchanged.

3. Analysis of monetary policy options

All five Board members noted that during the last few months inflation has evolved in line with projections and the various indicators of inflation expectations were within the two-year target of 3%. They also emphasized that core inflation was lower than expected. In this context, the upside risks raised earlier in the year had moderated. All this in a scenario in which activity at the turn of 2025 had been higher than foreseen, but its medium-term outlook remained unchanged.

The Board members coincided that it was the external events that brought the most news. The June IPoM included an assessment of the possible effects of the U.S. trade policy on the Chilean economy. The results pointed to downward effects on activity and inflation, albeit of a limited magnitude. However, the uncertainty surrounding this process was also highlighted, which could alter these conclusions. An important focus of risk was the behavior of global financial conditions, which had been more benign than expected in the face of a shock of this magnitude and explained a significant part of the limited impact that was estimated.

The Board also agreed that, in a macroeconomic scenario that generally changed little with respect to the latest reports and where upward risks for inflation were moderating, it followed that the monetary policy rate (MPR) should gradually approach its neutral values. Therefore, two options were considered for this Meeting: (i) keep the MPR at 5%; (ii) lower it by 25 basis points, to 4.75%.

They agreed that, in a materialized June IPoM scenario, the moment to start nudging the MPR towards the neutral value range depended mostly on tactical and communicational factors.

Some Board members noted that, although market expectations largely expected the rate to be maintained at this meeting, there was also a consensus in these measurements that in the short term the MPR would be reduced. Therefore, they estimated that a cut at this meeting should generate no major disruptions in financial variables. Some Board members pointed out that the macroeconomic impact of bringing forward by one meeting the MPR cut was low, because the market rates' trajectory already acknowledged that there would be cuts in the near future. Therefore, the gains from advancing the decision fell short with respect to any possible misreadings that might be made.

All five Board members drew attention to the implications of the Iran-Israel conflict, agreeing that since so little time had elapsed it was premature to assess its short- and medium-term impacts on inflation and monetary policy.

One Board member noted that, for the moment, the conflict had not substantially affected the prices of either fuels or financial assets, so it could be inferred that it caused no substantial changes to the central scenario. However, this Board member added, the conflict was still latent and events that could have an impact on inflation expectations like, for example, a significant rise in oil prices, could not be ruled out, which made it advisable to wait for events to play out. One Board Member said that "hold" seemed a more appropriate decision in view of the greater uncertainty generated by the armed conflict. All the Board members agreed that, in an uncertain environment, holding the rate was the wisest decision, provided that it was clearly stated that, if the central scenario of the June IPoM materialized, in the coming quarters the MPR would be approaching its neutral value range.

4. Monetary policy decision

Governor Costa, Vice-Governor Novy and Board members Naudon, Céspedes and Soto voted for holding the monetary policy interest rate at 5%.