Monetary Policy Meeting[1]/

MARCH 2018

CENTRAL BANK OF CHILE

[1]/ This is a translation of a document originally written in Spanish. In case of discrepancy or difference in interpretation, the Spanish original prevails. Both versions are available at www.bcentral.cl

MINUTES OF THE MONETARY POLICY MEETING

Monetary policy meeting No. 255, held on 20 March 2018.

Present: Mario Marcel, Governor; Joaquín Vial, Board member; Pablo García, Board member; Rosanna Costa, Board member.

Also present: Alejandro Zurbuchen, General Manager; Juan Pablo Araya, General Counsel and Attestor; Alberto Naudon, Research Division Director; Beltrán de Ramón, Financial Markets Division Manager; Solange Berstein, Financial Operations Division Director; Gloria Peña, Statistics Division Director; Miguel Fuentes, Macroeconomic Analysis Manager; Enrique Orellana, Strategy and Communication of Monetary Policy Manager; Matías Bernier, Domestic Financial Markets Manager; Luis Álvarez, Communications Manager; Hermann González, Advisor to the Finance Minister; Marlys Pabst, Secretary General.

1. Background analysis and discussion

The information presented to the Board and analysis thereof was that contained in the March Monetary Policy Report. Primarily, it showed that growth in activity had increased in recent months, particularly in the non-mining sectors. The revision of National Accounts data showed that growth in the non-mining sectors had recovered its dynamism in the second half of 2017, after a slow start of the year. With this, 2017's growth had been —on average— fairly as expected, but with a composition that provided a better starting point for 2018, which was relevant in the revision of the growth forecast for the current year. On the external front, the momentum driving the Chilean economy had consolidated above expectations, with favorable financial conditions, world growth that would outpace earlier years and commodity prices that had persisted above year-ago levels. Early February figures had revealed a period of greater volatility, with decreases in the prices of risky assets and higher global uncertainty. However, this period had been of short duration and its effects had not been very persistent. Domestically, during the last few months inflation had behaved in line with expectations, remaining near 2%. Still, in the projections of the new baseline scenario, the convergence of inflation to 3% would take longer than had been thought in December, given the additional appreciation of the peso in recent months. Toward 2019 and 2020, these projections assumed that inflation would accelerate, largely because the economy would close the activity gap gradually and steadily. This considered that, on average, the economy would grow above potential during the period 2018-2020. Regarding monetary policy, the Board had kept the monetary policy rate (MPR) at 2.5% for several months and, in the baseline scenario, estimated that it would keep the monetary stimulus near its current levels and would begin to reduce it conditional on macroeconomic conditions consolidating the convergence of inflation toward 3%.

During the discussion of these antecedents, several participants referred to the external economy, pointing out that the observed price adjustments associated with better perspectives in the developed world did not alter the scenario relevant for Chile. Some participants stressed that the better than expected global figures were drawing more attention to some downside risks, especially in the financial markets. One participant underscored the risks derived from a more expansionary fiscal policy in the US, when there were already symptoms of the gaps closing which, together with augmenting the external deficit, could add inflationary pressures. He also highlighted, due to their medium- and long-term implications, the risks associated with protectionist measures adopted by the US.

About the evolution of inflation and its fundamentals, the participants noted that inflation had remained on the expected trajectory for several months and soon it would be on a lower trajectory driven by the effects of the recent appreciation of the peso. All the participants emphasized that headline inflation was still low, as was core inflation, so there was a risk that inflation could stay low for longer than expected. Some participants added that while there was some degree of surprise about the pace of the economic recovery, the estimates of the current size of the gap and the evaluation of its implications for inflationary pressures were not very different from December's scenario. If this was coupled with a still relatively appreciated real exchange rate, it became clear that the risks for inflation were still present. One participant stressed that, in any case, the incorporation of higher growth into economic expectations had been undermining the arguments for an additional appreciation of the peso. In fact, in the weeks leading up to this Meeting it had rather experienced a depreciation.

All the participants noted that the recent and expected economic performance and its effects on the closing of the activity gap reduced the risks for inflation. Thus, they pointed out that after two years, the growth forecasts indicated that there the gap would close, helping inflation's convergence to the target with the current MPR. It was said that, actually, the inflation expectations reflected in longer-term market prices had changed very little in response to the peso's most recent appreciation. It was also noted that these perspectives for activity relied on a consolidated recovery of investment, more dynamic exports and consumption remaining strong, all of it supported by favorable financial conditions. One participant drew attention to the risks coming from the labor market. He mentioned that although the employment figures had tended to improve in the margin beyond the sectoral composition, nominal wages had continued, to some extent, growing at pretty low rates, which reduced the upward pressure on prices and was a factor to take into consideration in future decisions.

2. Analysis of monetary policy options[2]/

All the Board members agreed that, given the current economic conditions (depicted in the baseline scenario of the March Monetary Policy Report), the convergence of inflation to 3% in the usual horizon was consistent with keeping an expansionary monetary policy, in line with what several expectations surveys indicated. This was, keeping the MPR at its current level during this year and a gradual normalization towards neutral levels thereafter. Some Board members considered that the option to increase the monetary stimulus was still valid, in a context where inflation was expected to remain below the target for a long time and where the activity gap remained negative. Especially because even though the risk for inflation's convergence was clearly smaller, it had not disappeared. The main arguments in favor and against each of these options were:

Option 1: holding the MPR at 2.5%

All the Board members agreed that this option was consistent with the March Report's baseline scenario, particularly with the monetary policy strategy described therein. For this reason, and because of its alignment with market expectations for the macroeconomic outlook of the coming months, it was an option that ensured credibility and effectiveness. Furthermore, it provided space for a timely reaction if faced with some of the most likely risk scenarios.

Option 2: lowering the MPR by 25pb

Some Board members noted that this option would be justified from a risk management perspective, especially as long as core inflation remained below the tolerance range and low inflation rates were expected for a significant period of time. However, they agreed that it was very complex to explain this kind of decision considering the developments in the macroeconomic scenario. In particular, because inflation had not experienced additional downside shocks, such as new appreciations of the peso. Also because the medium-term projections pointed clearly to inflation converging to the target within the policy horizon, with smaller downside risks. In addition, considering developments of the macroeconomic scenario, it was highly probable that the decision to cut the MPR would have to be reversed in the short term, thus eroding its effectiveness and making it even more difficult and confusing to justify.

3. Agreed policy action

The Board decided, with the votes of Governor Marcel and Board members Vial, García and Costa, to keep the monetary policy interest rate at 2.5%.

[2]/ In order to preserve the regulatory individual anonymity in the discussion, all five Board members are herein referred to as males, including female member Ms. Rosanna Costa.