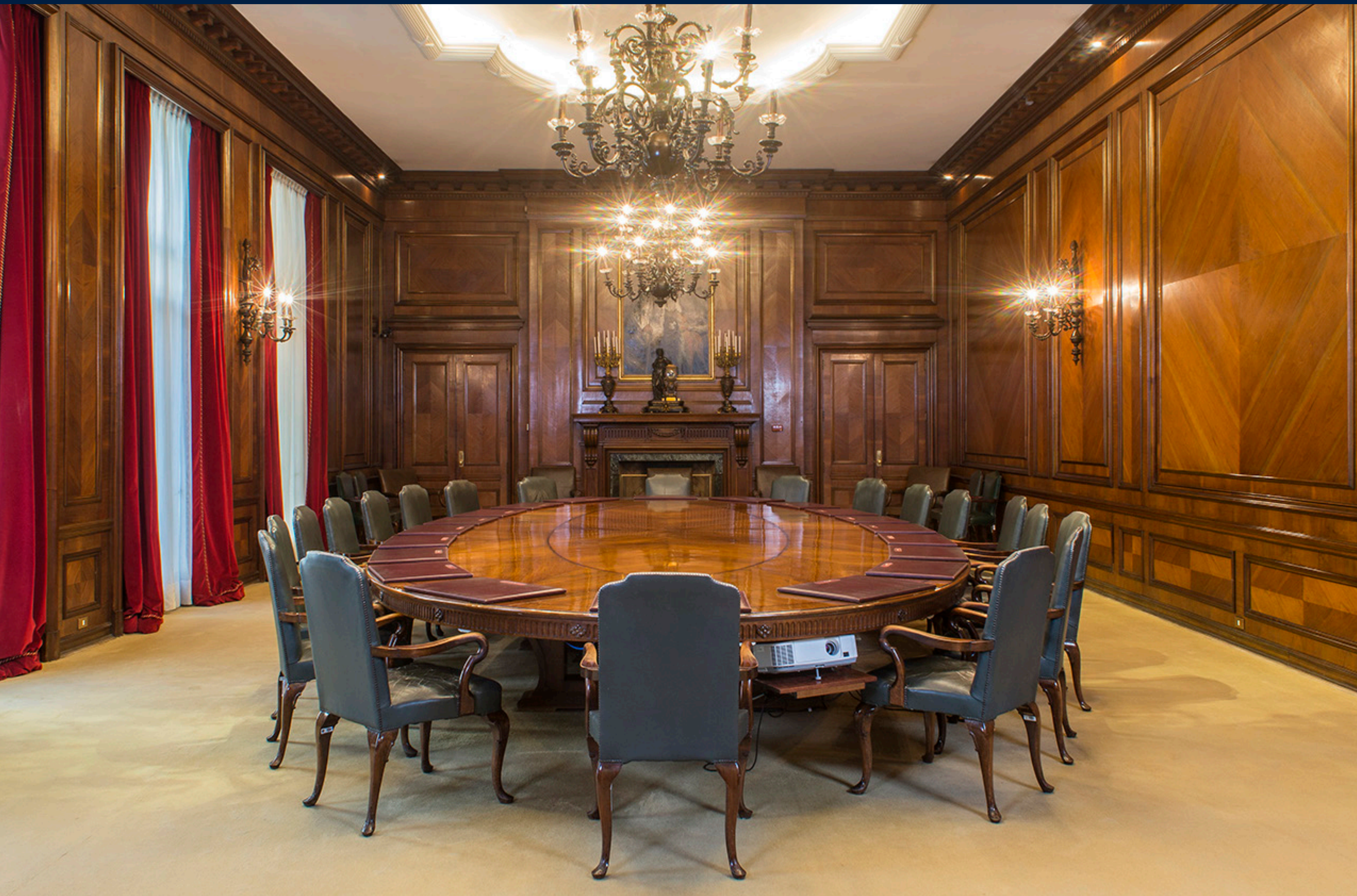
banco central Chile

MONETARY POLICY MEETING

MAY 2021



MONETARY POLICY MEETING

Monetary policy meeting No. 281, held on Wednesday 13 and Thursday 14 May 2021.

Present: Mario Marcel, Governor; Joaquín Vial, Vice-Governor; Pablo García, Board Member; Alberto Naudon, Board Member; Rosanna Costa, Board Member.

Present the Finance Minister, Rodrigo Cerda.

Also present: Juan Pablo Araya, Legal Counsel and Attestor; Elías Albagli, Monetary Policy Division Director; Beltrán de Ramón, Financial Markets Division Director; Solange Berstein, 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; Andrés Fernández, Economic Research Manager; Juan Carlos Piantini, Financial Markets Analysis Manager; Diego Gianelli, Market Operations Manager; Juan Francisco Martínez, Financial Stability Manager; Francisco Ruiz, Macroeconomic Statistics Manager; Felipe Lozano, Communications Manager; Tatiana Vargas, Senior Economist; Pilar Cruz, Senior Economist; Cristóbal Gamboni, Advisor to the Finance Minister; Marlys Pabst, Secretary General.

1. Background

The domestic scenario

Activity had grown well above estimates. The March Imacec had risen 6.4% annually, having decreased only 1.6% with respect to February, despite the fact that in that month the number of quarantined people had soared to more than 80% of the national population. This suggested, in part, that agents had adapted better to the sanitary context, which was also expected to be reflected in a lower impact of the quarantines in April and May, which was already evident in the data on mobility, electricity generation and sales with digital invoices and receipts. By sectors, trade continued to lead as the best performer. Construction and services, although maintaining their recovery trend, had not yet reached pre-pandemic levels of activity, while manufacturing and mining had already done so. On the domestic spending side, incoming data indicated that consumption remained dynamic, supported by the high liquidity resulting from income support measures, as evidenced by the retail trade activity index (INE) and automobile sales (ANAC). Regarding investment, the rebound in capital goods imports continued to give signs of recovery.

In this scenario, growth expectations for this year contained in the May Economic Expectations Survey (EES) had been adjusted upwards to 6.2% annually (5.3% in March).

Additional information compiled in the May Business Perceptions Report (IPN) showed that, despite the negative effects of the tightening of sanitary restrictions on performance since March, the respondents were still betting on a better 2021 than 2020, although with heterogeneity among different sectors and company sizes. In any case, the uncertainty related to the pandemic, particularly regarding sanitary measures and, to a lesser extent, the political scenario, had increased from a few months before, which had led in some cases to hiring and investment plans being postponed or cancelled.

The labor market was showing a significant rise from the poor employment levels of mid last year, with magnitudes varying depending on the occupational category and economic sector. There were also differences across multiple sources of information. Thus, while the data on the number of dependent contributors of the pension fund system (AFPs) suggested that formal salaried employment was already nearing its pre-pandemic level, INE data pointed to a milder rebound. For their part, hours actually worked had decreased since the previous Meeting, in a context of still constrained labor supply. A large number of respondents to the May IPN reported difficulties in recruiting personnel, especially lower-skilled workers. This was related, in their opinion, to fear of contagion, increased income support measures including pension savings withdrawals. The Internet Job Postings Index and IMCE hiring expectations continued to reflect higher labor demand, although with some pullback in the latter in April.

Some idiosyncratic elements were gaining relevance in the behavior of the local financial market. In the fixed-income segment, the 10-year nominal rate had risen by 30 to 40 basis points (bp) more than its developed-economy counterparts since the beginning of March. Nominal and UF-indexed 2-year bonds had accumulated significant increases, i.e., more than 70 bp in indexed ones since the previous Meeting, where the discussion around a possible transitory reduction of the VAT was among the main factors behind the correction. Meanwhile, the IPSA had fallen, while the exchange rate had appreciated, amid a sustained copper price increase to near record highs. After the approval of the third withdrawal of pension savings, the Bank had once again launched extraordinary measures to contain the financial volatility that could result from the associated adjustments to pension fund portfolios, including reopening the CC-VP.

As for bank credit, the activity of Fogape-Reactiva had continued on the rise, with disbursements close to US$4.5 billion and operations concentrated in smaller companies according to the latest available data. This program continued to underpin the performance of commercial loans, whose real annual growth had, however, turned negative. The high basis of comparison was relevant here, since in the same period last year many companies had drawn on bank credit lines to ensure liquidity at a time of high uncertainty. The consumer portfolio had reduced its annual contraction and the housing portfolio maintained a relatively stable performance (-16% and 4.8%, respectively in real annual terms in April). Interest rates remained low for all credit users. In terms of risk indicators, the banking system's delinquency rate remained contained overall. For consumer loans, in recent months this had played a part in the decline in provisions.

The Bank Lending Survey (BLS) for the first quarter reported a more dynamic supply for smaller companies, which was partly related to a lower perception of risk in this segment, aided by the continuity of credit support measures. The survey also reported a rebound in firms' requests for funds, especially for working capital, as was also confirmed by May's IPN. However, the latter also revealed that a fraction of the companies needing financing did not request it because of capacity issues, financial burden or unfavorable conditions, among other reasons. For households, the BLS revealed an improvement in both demand and lending standards in the consumer portfolio. IPN respondents linked to the banking sector added that the requirements for access to this type of credit were again similar to those in force prior to the pandemic, although a good part of these operations continued to be for portfolio purchases.

Annual inflation, both headline and core (i.e. CPI without volatiles) had continued to hover at around 3%. In the latest monthly figures—March and April—price hikes for gasoline and some foodstuffs had stood out again. This was compounded with an incipient rebound in the prices of non-managed or indexed services, as well as continued high demand and difficulties in the production and supply of several high-demand goods. This had been confirmed by interviewees in and respondents to the survey of the May IPN, who reported cost pressures in a greater number of sectors, which had often translated into price increases. Business expectations (IMCE) continued to reflect the prospect of cost increases going forward. One- and two-year-ahead market expectations for inflation were still standing around 3% annually, according to the May EES and the Financial Traders Survey (FTS) prior to this Meeting.

Regarding the unconventional measures in place, nearly 75% of the total FCIC3 available had been used up. In turn, since January the asset purchase program had been reinvesting coupons at maturity, a policy that would be maintained until June. Thereafter, the stock would be gradually reduced as the assets in the portfolio matured.

In this context, MPR expectations in the surveys (EES and FTS) showed increases of 25 to 50 pb one year ahead, while the prices of financial assets pointed to a rise of around 100 pb.

The international scenario

The international outlook was still evolving favorably, with global growth projections consolidating steadily. This, in a context in which the improved evolution of the pandemic and speed of vaccination had made it possible to relax sanitary restrictions, especially in developed economies. In particular, the dynamism of the United States during the first quarter (6.4 q-o-q annualized) stood out, consolidating a recovery driven by consumption. The Eurozone, on the other hand, had contracted in the first quarter, as a result of the extension and intensification of tightening measures during the first months of the year. However, the latest indicators showed a rebound in confidence and outlook, anticipating a faster recovery in the second half of the year, supported by progress in the vaccination processes, the high savings accumulated by households, and the fiscal stimulus plans. In the emerging world, China had seen positive quarterly growth, despite the reinstated restrictions during the period, with a more dynamic industrial sector, services that continued to recover and a solid external economy. In Latin America, activity had shown some resilience, although the worsening sanitary situation in several countries in the region, in the midst of sluggish vaccination processes, was compounded by some idiosyncratic factors of political and economic nature, which weakened expectations going forward.

International financial markets maintained a positive tone, encouraged by the sustained improvement in global growth expectations, mainly in developed countries. Since the March meeting, stock market indexes had risen and risk premiums in an important group of economies (EMBI and CEMBI) had fallen further, while most currencies had appreciated against the dollar and capital was flowing into the emerging bloc. Meanwhile, long-term interest rates remained above those of the beginning of the year, but still low by historical standards. Commodity prices had risen across the board, particularly for oil and copper, with the latter hovering around US$4.8 per pound on some days of May. Rising commodity prices, together with higher effective inflation registers, greater cost pressures and strong incentives to demand had increased concerns about inflation—specially in the U.S.—which had led to some volatility in the financial markets. While most monetary authorities had maintained their stimulus policies, some had already announced or started the withdrawal of some of the unconventional measures, particularly in countries that already presented better growth prospects or were seeing inflationary risks.

2. Background analysis and discussion

About the international scenario, it was stressed that the Chilean economy would receive a considerable external impulse this year. Global growth had consolidated with good numbers in the main economies, while financial conditions continued to be very positive and the main central banks remained committed towards highly expansionary policies. Last but not least, the prices of copper and other commodities had far exceeded projections. Although some correction was to be expected, it was clear that on average they would be well above estimates of just a few weeks before. In any case, it was also pointed out that, particularly in the United States, the macro policy mix seemed to be incubating inflationary risks that were not negligible. For the moment, this phenomenon was mostly circumscribed to the US economy, but there were reasonable doubts as to how widespread it might be across the world. In fact, this heightened concern about inflation had fueled some recent adjustments in the markets, although expectations remained anchored.

On the domestic front, the favorable evolution of demand and activity indicators was noted, as it had been outperforming expectations since the end of last year. This occurred in a context in which the evolution of the external scenario had so far been beneficial for Chile, boosting foreign trade and facilitating the execution of expansionary fiscal and monetary policies. Also noteworthy were the improved capacity of companies to adapt to the sanitary restrictions, a positive flow of credit oriented to the worst affected companies, a substantial volume of support to households suffering income losses, and substantial progress in the Covid-19 vaccination program.

Nonetheless, it was noted that the application of new quarantines, lags in the recovery of the labor market and political tensions had significantly deteriorated consumer and, though somewhat less, business expectations. This negative climate had led to significant benefit extensions for households and small businesses, reflected in a third pension savings withdrawal approved in April and in the ongoing discussion about extensions to the coverage and amounts of fiscal transfers to households. The combination of these factors had resulted in increases in long-term interest rates on local bonds in excess of those on U.S. Treasury bonds.

Regarding credit, it was mentioned that the annual variation rate of the stock of commercial loans was beginning to turn negative in real terms. Although this seemed to be largely explained by the high basis of comparison, another possibility was that, once the most difficult stage of the sanitary emergency was over and a sales had recovered, many companies had begun to reduce their future financial burden, either through amortizations or rescheduling. On the other hand, the fall in the stock of consumer loans was consistent with the increase in household liquidity provided by pension fund withdrawals and transfers from the Treasury.

On the labor market, attention was drawn to the fact that the data showed both employment and wages were improving. However, it was also pointed out that the employment increases were concentrated mostly in salaried jobs, while self-employment lagged far behind. The data also showed a still very slow recovery in labor force participation, which was consistent with the difficulties faced by caregivers of children, the sick and the elderly, in a context of pandemics, on-line schooling and closed medical and elderly care centers. All in all, it was pointed out that, beyond the differences across multiple indicators, it was clear that the recovery of the labor market was quite significant with respect to the lowest point associated with the pandemic.

The changes that had occurred in some of the risks identified in March were also noted. On the one hand, the risks related to the pandemic had moderated, particularly because the progress made in the vaccination campaign opened up the prospect of a sooner, albeit partial, return to normal life. This fact, as well as available first-quarter data, the greater adaptation of the economy and the increases in stimulus measures made it possible to dispel scenarios of a weaker recovery in consumption or a greater-than-expected effect of quarantines. On the other hand, idiosyncratic risks had become more prevalent, as could be inferred from market prices. Accordingly, the exchange rate seemed to have appreciated less than expected considering the increase in the copper price, and sovereign rates incorporated external developments, but also term premiums more closely associated with local factors. All this occurred in a context of heightened political tension and new legislative initiatives that, beyond their short-term benefits, would impose costs that would have to be assumed in the medium and long term. On top of it, there was the greater concern about global inflation, which was becoming one of the main medium-term risks in the financial markets.

3. Analysis of monetary policy options

All five Board members agreed that the recent evolution of the external and internal scenarios, the stronger fiscal impulse and boost to private consumption that the additional stimulus packages would entail, plus the reduction of some risks, permitted estimating that Chile's economic outlook was now significantly improved compared with estimates in the March Monetary Policy Report. This positioned our economy near the positive sensitivity considered in the scenarios of that MP Report.

In any case, the Board agreed that the moment the normalization process would begin remained highly uncertain. In particular, because despite the greater expansion of demand and activity, other factors also had to be considered when assessing medium-term inflationary pressures, including the persistence of the lags in the sectors most affected by the pandemic, the labor market's evolution, and possible structural changes caused by the crisis itself.

All the Board members agreed that the June MP Report would be particularly relevant to elucidate some of these issues. By that time, April activity data would be available, so it would be possible to verify how much more resilient the Chilean economy had become to quarantines such as the one initiated in late March that had involved a major portion of the population. By then, the initial impact on private consumption of the third pension savings withdrawal, which was preliminarily estimated to be less than for the previous two, could also be assessed. In the political sphere, by the June MP Report, the election process would have already been completed and the conversations regarding the adjustment of government support to households and small businesses would have been advanced or even concluded. With respect to sanitary matters, progress in the vaccination campaign and its impact on the dynamics of the pandemic could be evaluated with greater certainty. In addition, the June MP Report would contain an update of the structural parameters of trend growth and the neutral interest rate, which would allow for a reassessment of the activity gap and the degree of expansiveness of monetary policy. Consequently, all the Board Members agreed that it was prudent to hold back any substantive definition on the future evolution of the monetary policy for that instance, keeping the MPR at its technical minimum at the present Meeting.

4. Monetary policy decision

Governor Marcel, Vice-Governor Vial and Board members García, Naudon, and Costa voted for holding the MPR at 0.5%. They also agreed to effect no changes to the unconventional liquidity and credit support measures.