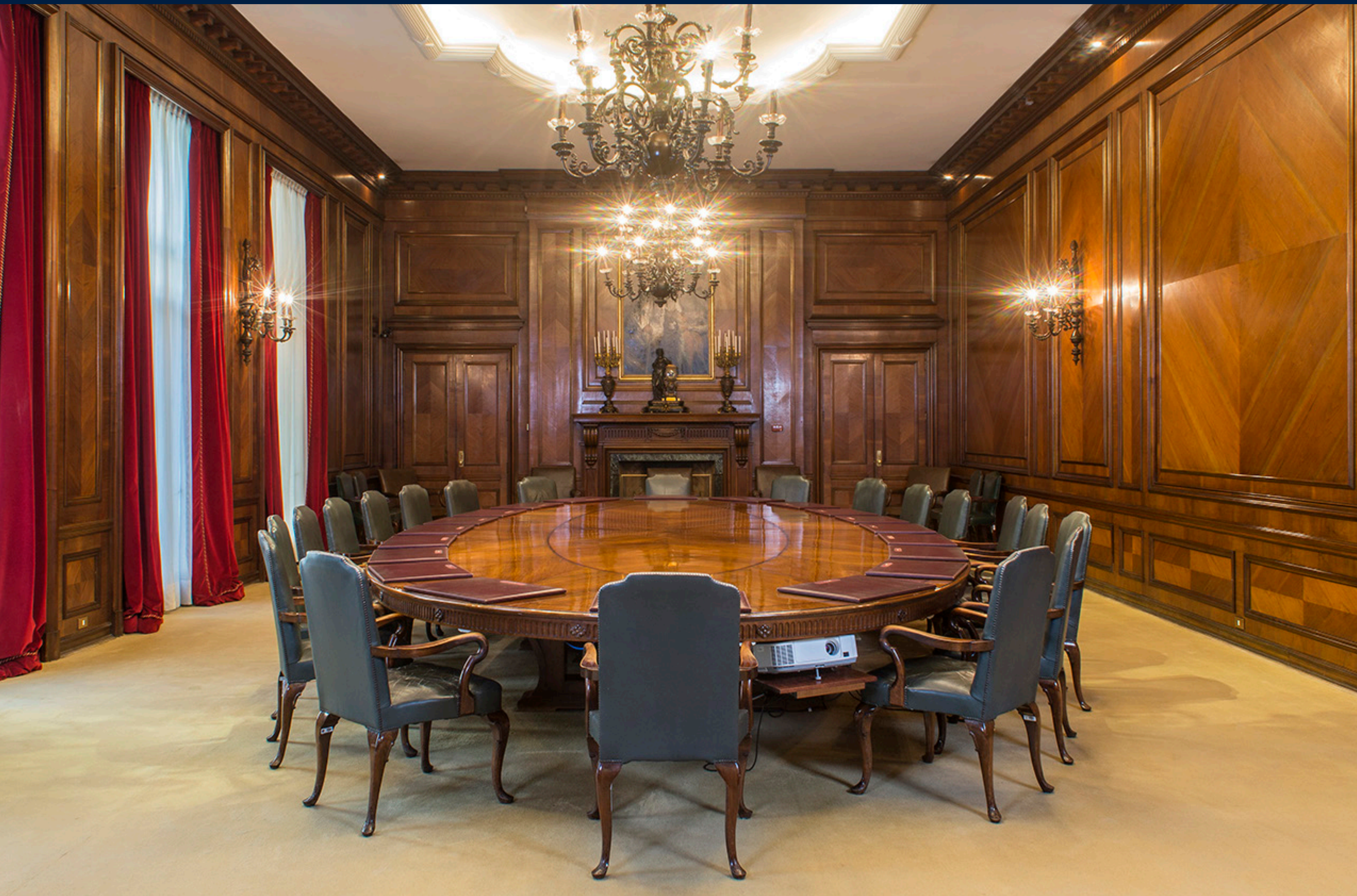
MONETARY POLICY MEETING

OCTOBER 2022



MONETARY POLICY MEETING

Minutes of the monetary policy meeting No. 293, held on 11-12 October 2022.

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

Also present: Juan Pablo Araya, Legal Counsel and Attestor; Elías Albagli, Monetary Policy Division Director; Paulina Yazigi, 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 Pollicy Strategy and Communication Manager; Miguel Fuentes, International Analysis Manager; Felipe Musa, acting Market Operations Manager; Juan Carlos Piantini, Business Strategy Administration 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 domestic scenario

Headline inflation had reached 13.7% annually in September, slightly less than in August, while core inflation —the CPI minus volatiles— had risen to 11.1% annually. Cumulative inflation in the last two months had exceeded the forecast in the September MP Report, owing mainly due to sharp price increases in some foods and, though not as sharp, in some services, mainly for administrated and indexed items.

Cost pressures were giving mixed signals. On the one hand, nominal wages and the exchange rate had risen again, while, on the other hand, commodity prices had declined and global supply problems had been moderating. The business cost outlook (IMCE) remained near record highs. Inflation expectations taken from the Economic Expectations Survey (EES) and the Financial Traders Survey (FTS) remained above 3% in the two-year horizon and had been adjusted downward in the one-year term.

The non-mining Imacec for August (+1.3% annually; +0.7% monthly seasonally adjusted) had surpassed the forecast in the September MP Report, mainly because of greater activity in some services. In all other sectors, however, the expected drops in activity were confirmed, as was the case in trade, manufacturing and construction. In domestic spending, private consumption indicators had continued to consolidate the expected adjustment path. Those linked to investment remained weak, although in some sectors —energy, transportation and telecommunications— there was a certain resilience that had favored the import of machinery and equipment. The consumer confidence index (IPEC) remained in the pessimistic zone, but with some recent rebound. The same behavior was observed in the case of firms (IMCE) across the different economic sectors.

In the labor market (INE), job creation remained stagnant, while the participation and unemployment rates showed no material changes, the latter standing at 7.9% in August. Labor demand had continued to lose strength, as reflected in the steady decline of the Internet Job Postings Index since the end of 2021 and of business expectations for employment (IMCE). Real wages continued to post negative annual variations in their different measurements.

The local financial market had aligned itself with the lower risk appetite of global markets. Compared with the previous meeting, the exchange rate had depreciated by around 5%, long-term interest rates had risen —especially UF-denominated—, the sovereign risk premium (5-year CDS) had increased and the IPSA stock index had lost close to 7%.

Bank credit continued to decelerate in all portfolios. Commercial and consumer loans had been falling further, with real annual contractions of 2.2% and 3.0% in September, while the annual variation of mortgage loans was at an all-time low, at 1.8% in the same month. These developments were in line with the latest Bank Lending Survey (BLS), which reported that supply conditions remained tight, driven by factors such as a perception of increased risk and a worsening economic environment. The BLS also pointed to a weaker demand, which for individuals was especially noticeable in the housing segment. Lending interest rates had seen further hikes in the margin.

The market outlook for the monetary policy rate (MPR) had increased. The various measures of expectations available (i.e., taken from surveys and financial asset prices) placed it at 11.25% at the October meeting, and then peaked between 11.25% and 11.5% at December.

The international scenario

Global inflation had continued to show signs of greater persistence, central banks had further raised their benchmark rates and market expectations pointed to a prolonged monetary tightening in developed economies. At its September meeting, the Federal Reserve had again raised the Fed funds rate range by 75 basis points (bps) and the FOMC's rate outlook suggested future rate hikes outpacing market expectations. The European Central Bank had raised its monetary policy rate by 75bp and signaled additional increases due to persistent inflationary pressures and the risk of expectations becoming unanchored.

The Bank of England had added 50 bps to its benchmark rate, amid high pressures from wages. In the U.K., the announcement of a fiscal stimulus package and tax cuts had sharply depreciated the pound and raised interest rates, which had prompted the Bank of England to establish a temporary purchase of long-term bonds in view of the increased risk of financial instability.

In Latin America, monetary authorities had kept on raising their monetary policy rates; however, some had surprisingly made more moderate increases than expected in the face of early signs that inflation had reached a peak in several economies. Brazil was a case in point, where the central bank had paused last September its rate hike cycle begun in March 2021, without ruling out new increases in the months ahead.

The market outlook for global growth had continued to adjust downward, mainly for 2023. In the United States, the combination of high inflation, tighter monetary policy and worsening financial conditions had contributed to a deterioration in next year's outlook, although projections for 2022 had remained stable, amid still resilient consumer indicators and a still strong labor market.

In the Eurozone, uncertainty surrounding the war in Ukraine continued to affect expectations about energy availability. Meanwhile, the real-income decline and the drop in confidence augured weak consumption. Furthermore, the tightening of financial conditions, the persistence of the negative supply shock and the worsening economic outlook continued to anticipate an erosion of investment dynamism.

In China, adding to the weakness of the real estate sector and the uncertainty regarding the strategy for controling the spread of Covid-19, there were the effects of the deteriorated world demand for goods on the country's exports. In Latin America, activity had shown greater resilience than expected; however, there were signs of moderation in the pace of growth. Thus, the revisions of the projections for 2022 went in opposite directions among the different economies, but for 2023 they continued to deteriorate, amid the worsening global outlook, tighter financial conditions, lower commodity prices and risks of internal tensions in different countries.

In this scenario, global financial markets had remained highly volatile and risk appetite had declined. Since the last Meeting, the dollar had continued to strengthen globally, stock markets had fallen and long-term interest rates had risen.

Commodity prices, in general, had continued to adjust downward, in line with the stronger dollar and the worsening outlook for world activity. The oil price had shown high volatility, with sharp declines and a subsequent recovery in the face of less favorable news on the supply side. Thus, in the days prior to the Meeting, the oil barrel was trading around US$90 (WTI-Brent average). Similarly, the copper price had shown fluctuations and was close to US$3.5 per pound, virtually unchanged from the last Meeting. The price of European natural gas had dropped significantly, despite disruptions in Russian supplies. Food prices had shown mixed movements. Edible oils prices had fallen, while cereals had risen, influenced by the uncertainty about new interruptions in grain exports from Ukraine.

2. Background analysis and discussion

Regarding the external scenario, there was agreement that it had worsened in recent weeks. It was pointed out that inflationary pressures remained high in both developed and emerging economies and, if anything, the phenomenon had become more persistent than expected. Consequently, monetary policies were becoming more contractionary in most countries, most notably in the U.S. It was pointed out that, although the markets had been adjusting to the change of scenario without major and generalized disruptions, global financial conditions had been tightening, growth projections were being downgraded again and commodity markets were becoming weaker.

There was consensus that not only would the external impulse to the Chilean economy diminish, but also that the probability of seeing negative risk scenarios had increased. Both the possible impacts of a more contractionary U.S. monetary policy on the rest of the world and the vulnerabilities in some important financial markets, such as developments in the United Kingdom were noted. The development of other sources of uncertainty already present was added, such as the war between Russia and Ukraine and the weakness of the Chinese economy and the consequences of its real-estate sector adjustment.

Regarding local conditions, there was general agreement that there were no substantial differences with respect to forecasts in the September MP Report. On the activity side, beyond surprises in some sectors, activity had evolved in line with expectations. The sectors most closely linked to the business cycle showed a clear adjustment and consumption was in line with expectations. Also noteworthy was the presentation to Congress of the fiscal budget for 2023, which, in general terms, seemed consistent with the Report assumptions, especially the importance of fiscal consolidation and the absence of other macroeconomic stimuli aimed at efficiently achieving the convergence of inflation to 3%.

The trajectory of inflation was noted, with its slight decline in the annual variation rate after many months of sharp rises. It was added that, in any case, in line with expectations, core inflation continued to rise, which maintained the alerts about the consolidation of a downward inflationary trend.

It was mentioned that the depreciation of the peso would drive up inflation in the short term, as was reflected in prices and market expectations. In any case, being the outcome of a global movement of the dollar, this increase in the exchange rate had different impacts on inflation than had previous ones, in which the depreciation responded more to factors from within. In addition, it had to be considered that, although the deterioration of the external scenario would put greater pressure on prices in the short term, medium-term inflationary pressures would be lower due to the negative consequences on economic activity.

The behavior of inflation expectations was also noted, which despite somewhat higher inflation in the short term, showed downward adjustments at longer horizons, probably reflecting the medium-term impact of a more deteriorated macroeconomic scenario. All in all, there was consensus that two-year expectations were still well above 3% and their evolution was a matter of concern.

Regarding local financial conditions, the weak growth in credit was observed, with its low or negative annual variation rates in its different categories. It was emphasized that this behavior was consistent with the rise in interest rates and with the evaluation of the third-quarter Bank Lending Survey, which reported that supply conditions remained constrained and demand was perceived as weak for all segments. The discussion focused on the behavior of shorter-term UF-denominated interest rates —typically more closely linked to the business cycle—, which had risen significantly in recent months, the origin of which was unclear, but which could end up having a significant impact on the economy.

3. Analysis of monetary policy options

All five Board members agreed that the information gathered since the publication of the last Monetary Policy Report outlined a central scenario in which medium-term inflationary pressures would gradually ease in line with expectations. In their view, this was a major change from several of the previous Meetings, where, in general, the data were showing the need for an increasingly contractionary monetary policy to ensure the convergence of inflation to 3% in the two-year horizon. There was also consensus that the inflationary problem was still present, inflation remains at high levels, persistence was high and the medium-term inflation expectations of different agents remained well above the 3% target.

In this context, all the Board members agreed that, in line with the September Report, the MPR was already near its maximum level. Therefore, an adjustment of the rate should be evaluated in order to reach a sufficiently contractionary degree to maintain it for the time needed to assess the impact of the changes in the macroeconomic scenario and ensure the achievement of the inflation target within the two-year horizon. The Board discussed two options: to raise the MPR by 25bp or by 50 bp.

In the Board's view, the option of raising the MPR by 25bp gave more time to assess the evolution of the macroeconomic scenario, particularly in terms of external developments and their impact on activity and medium-term inflationary pressures. It could also be evaluated positively if the weight assigned to external risks was very high. On the other hand, adopting this option could give the wrong signal regarding the Board's reading of the risks to inflation, particularly with respect to inflationary persistence.

Regarding the option of raising the MPR by 50bp, there was agreement among the Board members that adopting such a decision placed the policy rate at the level necessary to ensure the convergence of inflation to 3%, given the current macroeconomic environment. At the same time, it gave a signal consistent with the Board's concern about the persistence of inflation and reduced the risks associated with significant changes in external conditions. They also favored this option because it made it easier to give a clearly neutral bias to the next rate movements and allowed emphasizing that it would be kept unchanged for as long as necessary to ensure the convergence of inflation to 3% within the two-year policy horizon.

4. Monetary policy decision

Governor Costa, Vice-Governor García, and Board members Naudon, Céspedes and Novy voted for raising the MPR by 50bp, to 11.25%.