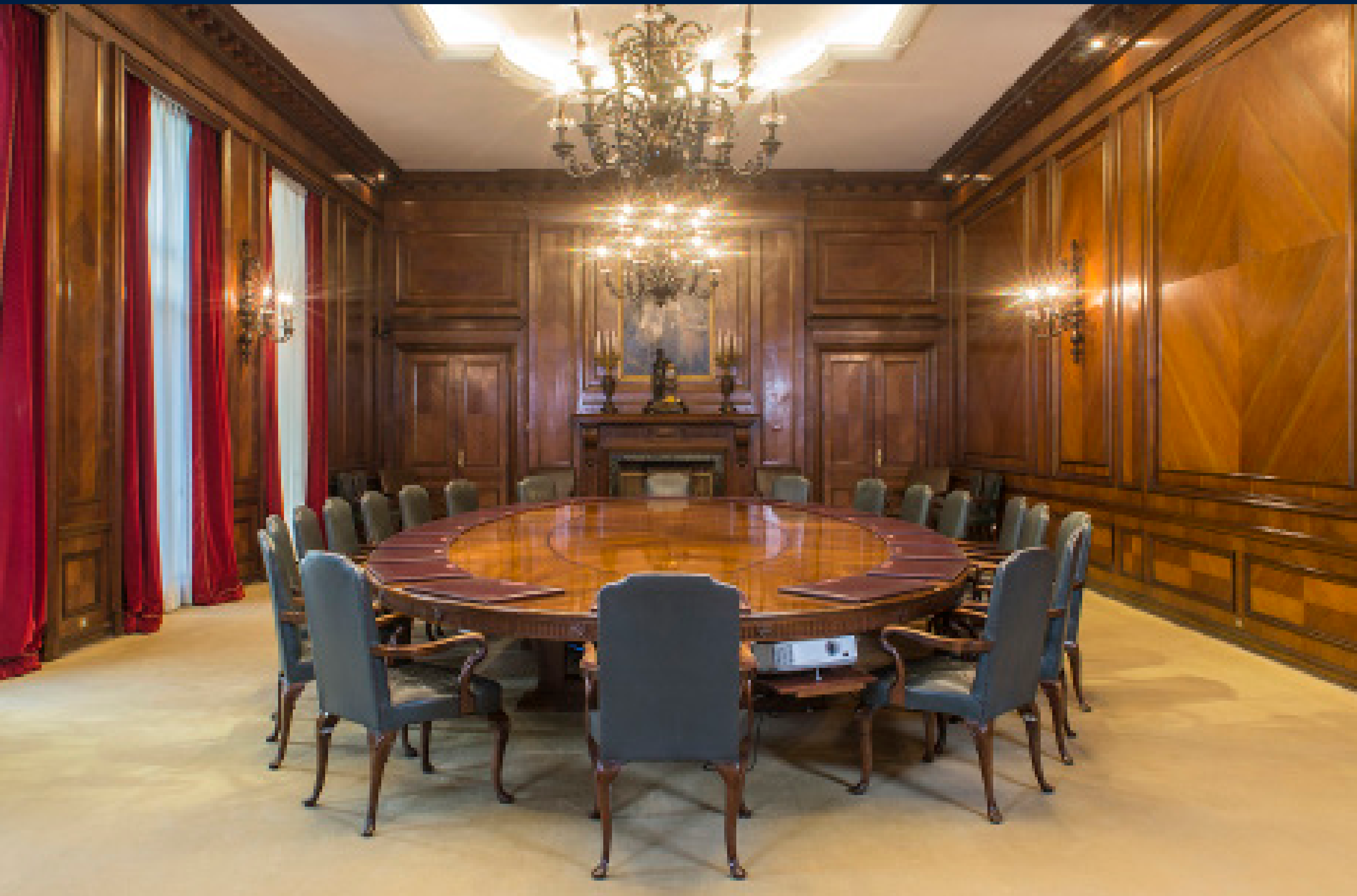
MONETARY POLICY MEETING

MAY 2023



MONETARY POLICY MEETING

Monetary policy meeting No. 297, held on 11–12 May 2023.

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

Present the Finance Minister, Mario Marcel.

Also present: Beltrán de Ramón, General Manager; Juan Pablo Araya, Legal Counsel and Attestor; Elías Albagli, Monetary Policy Division Director; Juan Carlos Piantini, acting 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 Policy Strategy and Communication Manager; Miguel Fuentes, International Analysis Manager; Sofía Bauducco, Economic Research Manager; Felipe Musa, Market Operations Manager; Felipe Córdova, acting Financial Stability Manager; Francisco Ruiz, Macroeconomic Statistics Manager; Juan Pablo Rioseco, acting Communications Manager; Andrés Sansone, Advisor to the Finance Minister; Erika Arraño, Senior Economist; Marlys Pabst, Secretary General.

1. Background

The domestic scenario

Both headline and core inflation had evolved as forecast in the March Monetary Policy (MP) Report. In April, the CPI annual variation had been 9.9%, in a decline consistent with the gradual adjustment of domestic demand, the normalization of the significant cost increases of previous quarters and the gradual pass-through of a more appreciated exchange rate. In core inflation, the fall had been more limited (to 10.3% annualized in April), which coincided with still high pressures on the services side. Most measures of inflation expectations two years ahead remained above 3%.

Preliminary first-quarter data —based on the Imacec— showed that the activity's performance had been in line with expectations in the March MP Report, beyond the meager performance of mining. On the demand side, consumption-related indicators had continued to adjust downwards, with a weak performance of imports of these goods and of retail sales, according to Imacec and digital invoicing data, among other factors. On the investment side, capital goods imports, construction indicators and the responses of interviewees to the May Business Perceptions Report (IPN) confirmed its weak status.

In the labor market, the unemployment rate had risen to 8.8% in the moving quarter ending in March (8.4% at February). Among other factors, this was explained by the reduction in employment and the increase in the labor force. Real wages continued to recover. This occurred in a context in which labor demand was still expected to weaken in the coming months, as suggested by the evolution of the Internet job postings index, the deterioration of companies' employment prospects (IMCE) and the greater slack in the labor market suggested by the opinions collected in the May IPN. In this scenario, the perception of the economy by employers (IMCE) and consumers (IPEC) remained on the pessimistic side.

Bank credit continued to show poor dynamism. Real consumer and commercial loans again showed annual contraction rates, which in April were at –2.1% and –5.3%, respectively. In the former, the persistent contraction of installment loans stood out again. Mortgage loans maintained modest growth (2.8% real annual change in April). The Bank Lending Survey for the first quarter showed that credit supply and demand had generally continued to weaken in all portfolios.

Surveys to experts, namely the Economic Expectations Survey (EES) and the Financial Traders Survey (FTS) and forward interest rates reflected expectations that the Monetary Policy Rate (MPR) would be maintained at this Meeting. All measurements coincided in that the first cut would take place between the July and September meetings, although they differed as to its magnitude. Thus, for September, the EES placed the MPR at 9.75%, the FTS at 10.25% and the forward curve implicit in swaps rates at 10.5%.

The international scenario

Headline inflation had declined in several economies, although core indicators remained high, reflecting the fact that the inflationary convergence process was not yet consolidated. In the developed world, different signs suggested that this would occur at a slow pace —one such sign was the tight labor market in some countries—, even though the medium-term expectations of various agents were close to their respective targets. The main central banks had continued to raise their benchmark rates, despite a mixed outlook for monetary policy. Thus, while in the U.S. the Federal Reserve (Fed) had shown signs of a possible pause, the European Central Bank had signaled that further rate hikes were in the horizon.

Global growth prospects for this year remained weak. In the main economies, the tightening of lending conditions, together with monetary tightening, were expected to negatively affect activity in the near future. In the U.S. the available data questioned a slowdown in consumption going forward, adding to the deceleration already shown by investment. In the Eurozone, consumption was also expected to be weaker, considering the deterioration of real wages. In China, although the actual figures had outperformed expectations, the boost associated with the reopening of the economy was expected to be transitory.

Global financial conditions showed no major changes in the last month, but uncertainty about their future evolution was significant. Fears about the performance of the world economy, the potential vulnerabilities of some banks and the evolution of credit in developed economies were particularly noteworthy. In the latter, some impacts on bank credit to companies were already visible. Discrepancies between the Fed and market projections for the U.S. monetary policy continued to leave room for possible financial turmoil, as did the discussion around the U.S. government's debt limit. In this context, currencies had appreciated against the dollar and stock markets had recorded slight increases, while long-term interest rates had risen only slightly in developed economies and declined in the emerging ones.

Commodity prices had receded, in line with the weak global economic outlook. Compared with the last Meeting, the oil price had fallen by just over 8%, although with high volatility during the last month, which included the impact of the unexpected announcement of production cuts by the OPEC. The drop in the copper price had been around 5.5%. On the day of the Meeting, the metal was trading at around US$3.7 per pound. This decline owed much to the effect of the slowdown in demand, which outweighed the impact of the continued tightness of the market.

2. Background analysis and discussion

Regarding the external front, it was noted that international financial conditions had tended to stabilize with respect to the last Meeting. However, they remained very sensitive to new information, in a context of greater uncertainty regarding future financial conditions. External risks continued to be high, due to both the probability of major disruptions in the banking system and an optimistic view of the markets regarding what it would cost to resolve the inflationary process in developed countries.

In the country, it was mentioned that the unfolding of the macroeconomic scenario was in line with the central scenario of the March MP Report. Output was slowly adjusting towards its potential level, as was consumption. Consumption was losing dynamism according to incoming information, although it was still above the levels traditionally consistent with output or household income. On the other hand, headline inflation had fallen again, driven by its more volatile components. Although it had returned to one digit after several quarters, it remained quite high. The evolution of core inflation was still a matter of concern. Its annual variation remained at levels between 10% and 11%, where it had persisted for several months. Going forward, it should come as no surprise that core inflation would decline much more slowly than headline inflation.

It was noted that the evolution of the labor market confirmed the signs of an adjustment consistent with the economy's performance and the usual lags between the two. On the one hand, unemployment was rising. Although this responded to a greater labor supply, it also reflected less dynamic hiring. In the latter, there was a predominance of self-employment. On the other hand, the Internet Postings Index continued to decline, indicating that the labor market would continue to adjust going forward.

3. Analysis of monetary policy options

The Board recalled that during the last meetings they had delivered a very clear message regarding the future evolution of the Monetary Policy Rate. It stated that the rate would be held at 11.25% until the state of the macroeconomy indicated that the convergence of inflation to 3% had been consolidated.

All five Board members agreed that, from the analysis of the background data, it could be concluded that there was still no evidence to affirm that inflationary convergence had been consolidated. For this reason, the only plausible option for this Meeting was to hold the MPR flat at 11.25%.

There was agreement at the Board that the performance of the economy was in line with forecasts in the March Report. It was pointed out that this was good news, especially after several quarters in which this had not been the trend. In fact, the usual pattern was to observe a string of shocks that were constantly modifying the macroeconomic outlook and affecting monetary policy decisions.

The Board agreed that the fact that total inflation fell and activity and consumption continued to adjust did not indicate that the inflationary problem had been resolved. That only realized that it was on the right path and that information still had to be accumulated to assess whether the convergence of inflation to the 3% target had been consolidated.

All the Board members reiterated the importance of the risks present, which could lead to scenarios of either higher or lower inflationary pressures. However, there was also agreement that, in the current context, the risks associated with scenarios of higher inflationary pressures were particularly complex and costly.

4. Monetary policy decision

Governor Costa, Vice-Governor García and Board members Naudon, Céspedes and Novy voted to maintain the MPR at 11.25%.

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