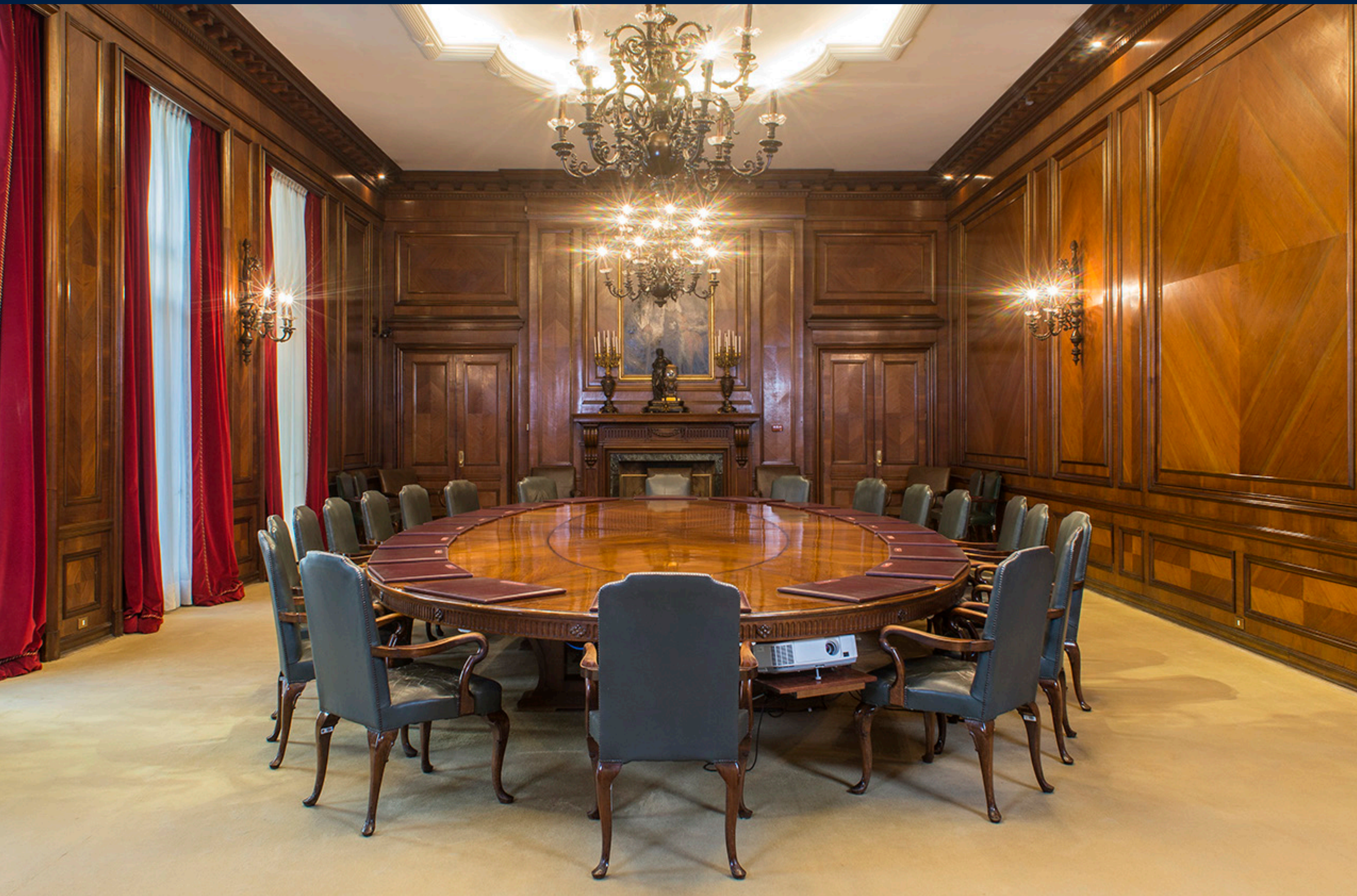
MONETARY POLICY MEETING

JUNE 2021



MONETARY POLICY MEETING

Monetary policy meeting No. 282, held on Tuesday 8 June 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; Felipe Lozano, Communications Manager; Cristóbal Gamboni, Advisor to the Finance Minister; Marlys Pabst, Secretary General.

1. Background

The background information for this Meeting was contained in the June Monetary Policy Report that was to be published the next morning. That Report noted that the recovery of activity had been a positive surprise in the first months of 2021, reflecting the strong macroeconomic stimulus and the economy's better adaptation to the sanitary restrictions. At the same time, inflation had performed relatively in line with expectations. In the past few quarters, private consumption had risen strongly, fueled by pension savings withdrawals and massive fiscal transfers. In addition to this, there were the recently approved reforms, which meant that fiscal policy would be significantly more expansionary than had been anticipated in March. The recent improved performance combined with increased stimulus to spending, in a context of more favorable external conditions, led to a significant increase in growth projections for this year, to a range between 8.5% and 9.5% (6% to 7% in March). The Report emphasized that even with these advances and better prospects for recovery, the general perception remained marked by the evolution of infections and quarantines, the significant lags of some sectors, the fragilities in the labor market and the persistence of high uncertainty. It was also stressed that the financial market had reacted to aggregate local events with an increase in long rates that diverged from the stability of their external counterparts, a fall in the stock market and moderate increases in sovereign risk.

The Report emphasized that higher growth in 2021 would bring forward the closing of the wide activity gap caused by the Covid-19 crisis, making it less necessary for the monetary impulse to support the economy's recovery, so it should begin to moderate sooner than anticipated in the previous Report. This would prevent an increase in inflation—around 3.5% at the time—from driving up the cost of living and eroding the purchasing power of the households most affected by the crisis. Even so, it was anticipated that, in the central scenario, the MPR would remain below its neutral level throughout the policy horizon, underpinning a recovery process that would continue to face important challenges.

2. Background analysis and discussion

On the external front, the strengthening of the global recovery, the performance of the stock markets and the increases in commodity prices were highlighted. If this were compounded by the greater stability of long-term interest rates, the outlook for global financial conditions was very positive. It was added that, meanwhile, this process was accompanied by greater cost pressures, which in any case were estimated to be transitory, as was reflected in market expectations. It was pointed out that, in any case, the latter did not prevent the risk of greater persistence of these cost pressures, which posed a risk in a scenario of high liquidity and considerable stimulus to demand. Particularly important was the case of the U.S., where inflation was already showing very significant surprises.

Locally, the impact of several factors on the recent evolution of the macroeconomic scenario stood out. On one hand, the sanitary situation showed a worsening in the evolution of infections while at the same time there was considerable progress in meeting vaccination goals, which gave significant support to the assumption that the economy would gradually open up as of the third quarter of the year, which underlay the Report's projections. On the other hand, activity figures confirmed that the recovery had been faster than expected, even in some services that strongly depended on human interaction. However, it was pointed out that this recovery was still very heterogeneous, which was especially evident in the labor market and left no doubt that there were still loopholes to be closed in the economy.

It was pointed out that, beyond the recent evolution of the external scenario or the better performance of the economy at the beginning of the year, the main novelty of the macroeconomic scenario was the substantial increase in the boost to private spending and the impact it would have on aggregate demand. This was accompanied by a series of fiscal measures and the implementation of a third withdrawal of pension savings. As this boost coincided with progress in the recovery of and improvements in the external environment, the activity gap was projected to close much faster than expected, together with an increase in inflation, which was already near 3.5%

3. Analysis of monetary policy options

All five Board members agreed that the fiscal expansion and the dynamism of consumption configured a macroeconomic scenario for the next two years in which it would be unnecessary to maintain such a highly expansionary monetary policy stance as the current one for such a long time as was expected until a few months back. In this scenario, the Board considered that holding the MPR at 0.5% was no longer the only possible option, and that the option of raising it by 25 basis points, to 0.75%, was also plausible.

All the Board Members agreed that deciding on one option or the other was fully consistent with the macroeconomic scenario and the required monetary policy stance. In the view of several Board members, the biggest difference stemmed from a tactical and communicational component: in particular, the need to inform the market of the change the Bank was observing in the macroeconomic scenario—which would be attained with the publication of the June Report—and to prepare it for the adjustments that would occur shortly. It was further noted that this meant a return to a more traditional way monetary policy making, where the Board defined stages, first establishing a bias and then implementing changes in the MPR. One Board member added that, in addition to tactical considerations, the decision to hold the MPR was justified on the grounds that the widening activity gap in the second quarter pointed to lower immediate pressures on inflation, which overlapped with the labor market still being far from a full recovery.

Although the Board considered it important to communicate the launching of the process of withdrawing the monetary stimulus, it also deemed it advisable to emphasize that monetary policy would remain expansionary for a long period of time. It was recalled that, despite the faster recovery and a greater boost to private spending, this would be temporary, as expenditure-boosting measures were phased out. Moreover, the economy was still immersed in a context where uncertainty was higher than it had been until a couple of years ago and where the prospects for investment and growth were constrained for the coming years. In this scenario, excessive tightening of local financial conditions could be counterproductive, and the Board would keep a watchful eye on economic developments. In fact, it was recalled that, in the central scenario of the June Report, it was anticipated that the MPR would remain below its neutral level throughout the entire policy horizon.

4. Monetary policy decision

Governor Marcel, Vice-Governor Vial, and Board members García, Naudon, and Costa voted in favor of keeping the monetary policy interest rate at 0.5%.

banco central Chile

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