Monetary Policy Meeting[1]/

MARCH 2019

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. 263, held on 29 March 2019.

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

Present: the Finance Minister, Felipe Larraín.

Also present: Alejandro Zurbuchen, General Manager; Juan Pablo Araya, General Counsel and Attestor; Elías Albagli, Monetary Policy Division Director; Beltrán de Ramón, Financial Markets Division Director; Rodrigo Alfaro, acting Financial Policy Division Director; Gloria Peña, Statistics Division Director; Michel Moure, Institutional Affairs Division Director; Miguel Fuentes, Macroeconomic Analysis Manager; Enrique Orellana, Strategy and Communication of Monetary Policy Manager; Matías Bernier, Domestic Markets Manager; Juan Pablo Rioseco, acting Communications Manager; Hermann González, Advisor to the Finance Minister; Marlys Pabst, Secretary General.

1. Background discussion and analysis

The information submitted to the Board and the analysis thereof are contained in the March Monetary Policy Report. Its contents show that, in line with forecasts, domestic economic activity recovered its growth pace after taking a pause in the third quarter of 2018. Activity's performance was being driven by investment. On the external scenario, it was noted that growth in the main economies had decelerated faster than expected, leading their authorities to implement further economic stimulus measures.

The Report noted that the main difference with respect to December's baseline scenario was due to domestic inflation. Measured by the new benchmark CPI calculated by the INE, inflation was significantly below the forecast. In a context in which activity and demand had been in line with projections, the lower inflation figure was consistent with a lower peso depreciation pass-through coefficient; favorable supply factors in some sectors and greater than expected gaps in the labor market resulting from massive immigration. In this context, the convergence of inflation to the target would occur later than foreseen in December, so the withdrawal of the monetary stimulus would take longer than had been announced by the Board.

Regarding the external scenario, it was mentioned that the risks of a drastic correction of asset prices had not vanished, despite announcements of several countries' economic authorities. It was said that, in fact, in recent days greater volatility had been observed and pressures had increased on those economies perceived as the weaker ones. It was also noted that, although a mild revision to world growth could be good news for emerging economies, as it would imply that the main central banks would adopt more expansionary monetary policies, probably the effect of the interest rate decrease would be lower than in other circumstances. However, the deflationary effects of potential appreciations of their currencies would still be present and strong. Summing up, although more benign scenarios could not be ruled out, a negative bias continued to predominate in the evolution of the external scenario.

Also in discussing the risks from abroad, it was said that one of the most important issues had to do with the reaction of emerging economies to a persistent strengthening of the dollar, while, at the same time, Europe, China and world trade were gradually weakening. It was mentioned that, unlike 2008, when the nature of the cyclical deceleration and its potential propagation and risks were quite evident, this time around the cyclical weakening had many origins and it was difficult to identify the fundamental forces that were governing it. Among them, the cycle's maturing process, which had taken quite long; political pressures in different places; the risk of a trade war; and financial stress. Figuring out the relative importance of each element was essential to gauge the effect of the external cycle on the Chilean economy.

On the domestic front, the annual national accounts had confirmed the direction and magnitude of the evolution of activity and demand during 2018. In the profile of activity during the year, a somewhat stronger-than-expected fourth quarter had been observed, confirming the transitory nature of previous quarter's slowdown. This was reinforced by the upward trajectory of investment during the year and consumption a little above forecasts. It was pointed out that the fact of consumption growing in tandem with GDP was consistent with the Bank's analysis of the labor market, which drew attention to how the economy had absorbed a significant immigrant flow. It was noted as well that the magnitudes of this flow had also been confirmed by the population projections published by the INE last December.

The implications of a possible combination of negative shocks from abroad with positive supply-side shocks at home associated with immigration and its labor market effects were discussed. On one hand, the effects on activity and employment would possibly tend to cancel out but, on the other hand, both scenarios implied lower inflation in the policy horizon. For the same reason, at least for now, more attention should be paid to inflation than to the activity gap. In that sense, a potential risk of inflation being below target for a very long time due to the intensification of these two scenarios was a possibility that should be evaluated in future Reports.

2. Analysis of monetary policy options

All five Board members agreed that the background analysis of the last Monetary Policy Report confirmed that it would be prudent to postpone the withdrawal of the monetary impulse. In particular, because inflation estimated with the new CPI was clearly lower than expected—which, among other things, had to do with the apparently bigger gaps due to the aforementioned supply shocks—and its convergence to 3% would take almost a year longer than thought in December. Moreover, there was uncertainty surrounding the structural parameters, such as potential growth and the neutral interest rate, something that would be resolved in the June Report.

All the Board members agreed that everything suggested that in the medium term it would be necessary to normalize the MPR and take it to its neutral level. However, in the short term the main concern was to understand the present level of inflation and what it meant for its future trajectory.

They all considered it difficult to justify a different option—in either direction—than holding the MPR flat at this Meeting. In particular, because as was also noted in the March Report, this pause in the monetary withdrawal needed to last for several meetings before resuming its path of normalization toward the neutral MPR.

3. Monetary policy decision

There was consensus among the Board members that the option to not change the MPR was the natural one and it was consistent with inflation converging to the target over the policy horizon. Moreover, it adapted better to the risk scenarios analyzed.

It was also agreed that not changing the MPR was proof of the coherence between the Bank's actions and communications, especially in that the monetary stimulus would be withdrawn gradually and cautiously. Actually, this caution was evident in the postponement of the normalization process, in light of new elements in the evolution of inflation and the interpretation of its fundamentals.

The Board decided, with the votes of Governor Marcel, Vice-Governor Vial and Board members García, Costa and Naudon, to keep the monetary policy interest rate at 3%.