

**Challenges in the implementation of Monetary  
Policy in Latin America:  
Some lessons from the Peruvian experience**

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**X Central Banking Operations (Digital) Meeting  
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CEMLA and Bank of Mexico**



**BANCO CENTRAL DE RESERVA DEL PERÚ**

# Contents

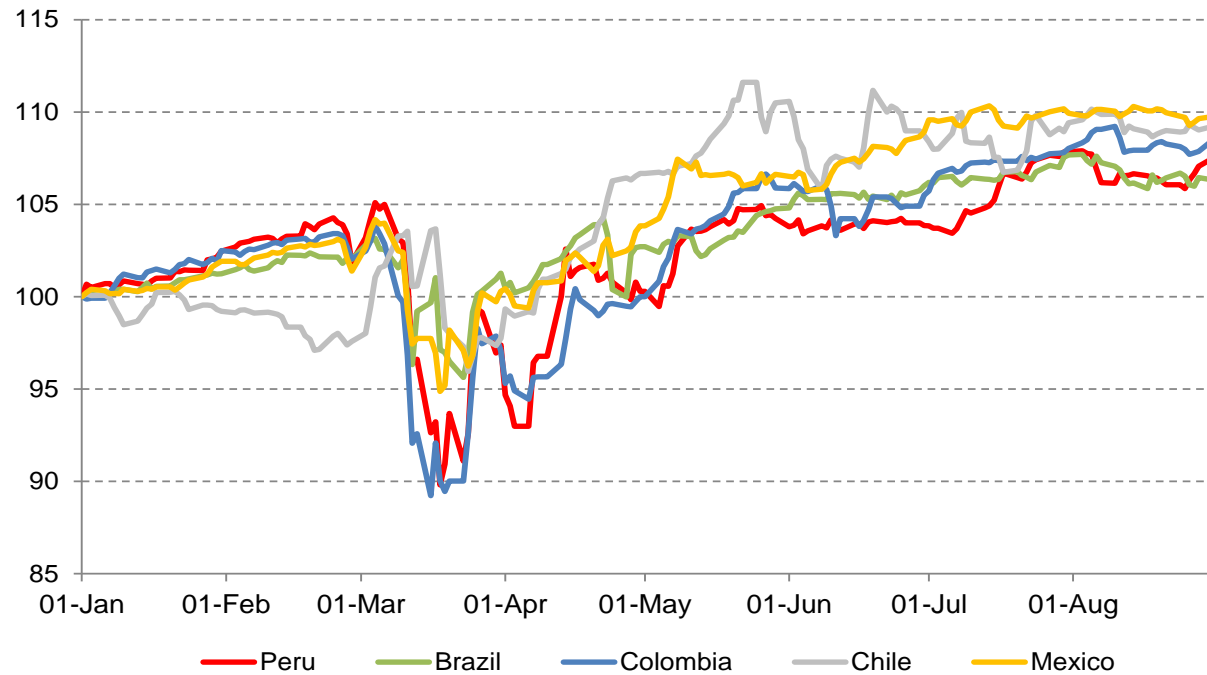
**The COVID 19 Shock**

**BCRP Monetary Policy and Unconventional Measures**

**Challenges Ahead**

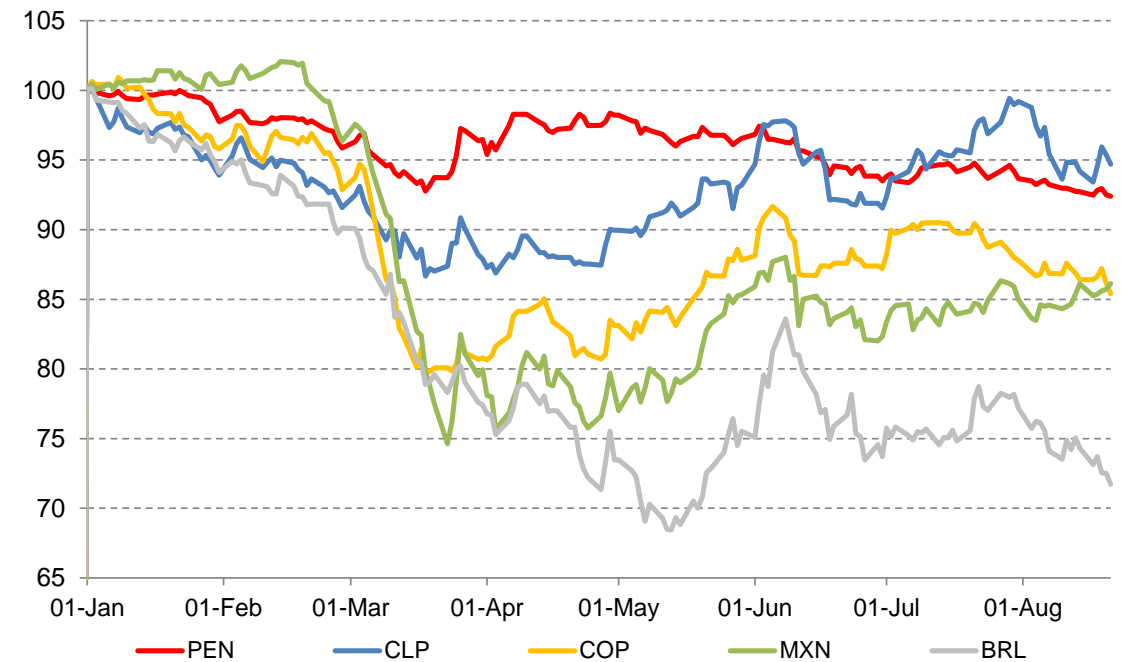
# Covid-19 shock triggered a sharp jump in financial markets volatility and a substantial increase in macroeconomic uncertainty with potential negative effects in financial stability.

**Latam 5: GBI-EM Index (Local Currency)**  
31Dec19 = 100



Source: Bloomberg

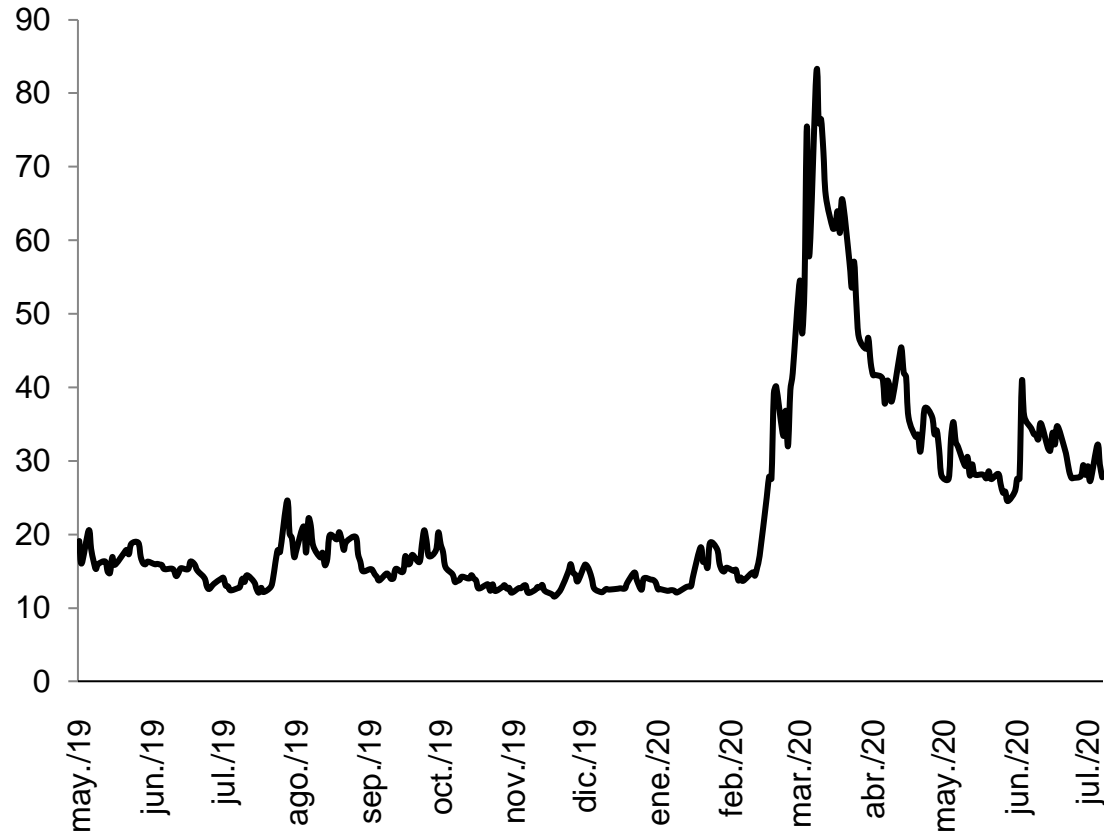
**Latam 5 FX**  
31Dec19 = 100



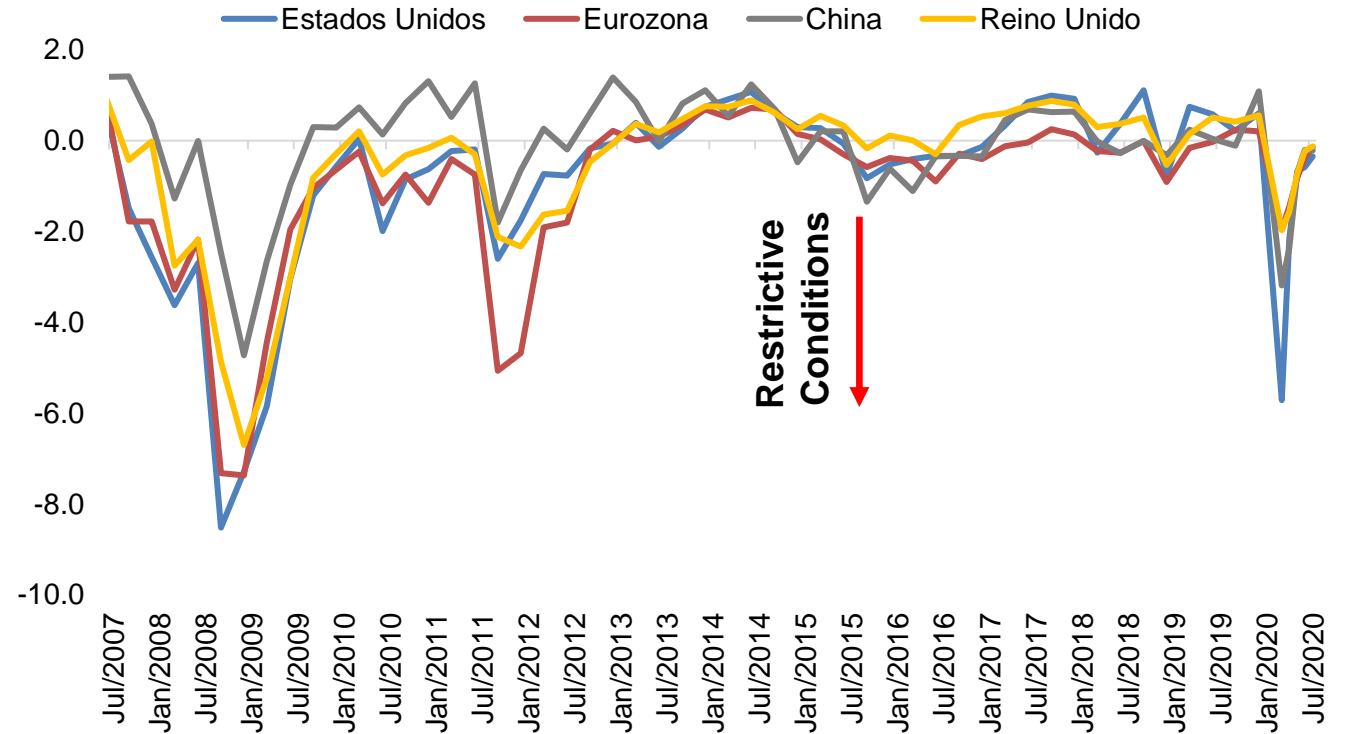
Source: Bloomberg

**Volatility in financial markets reached a peak in March and since then has declined in response to expansionary monetary and fiscal policy in advanced economies.**

**VIX (S&P 500)**



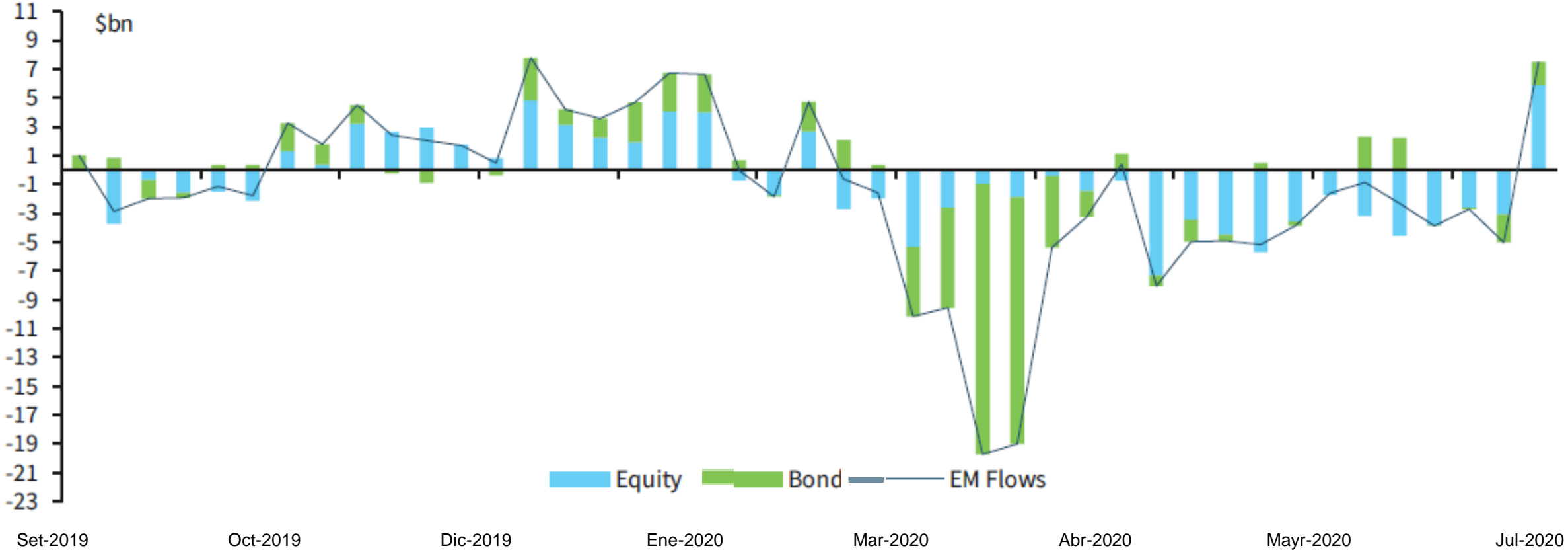
**Global financial Conditions1/**  
(base: 31-12-2019)



1/ The index measures the stress on money markets, bond and stocks to assess Access and cost of credit.

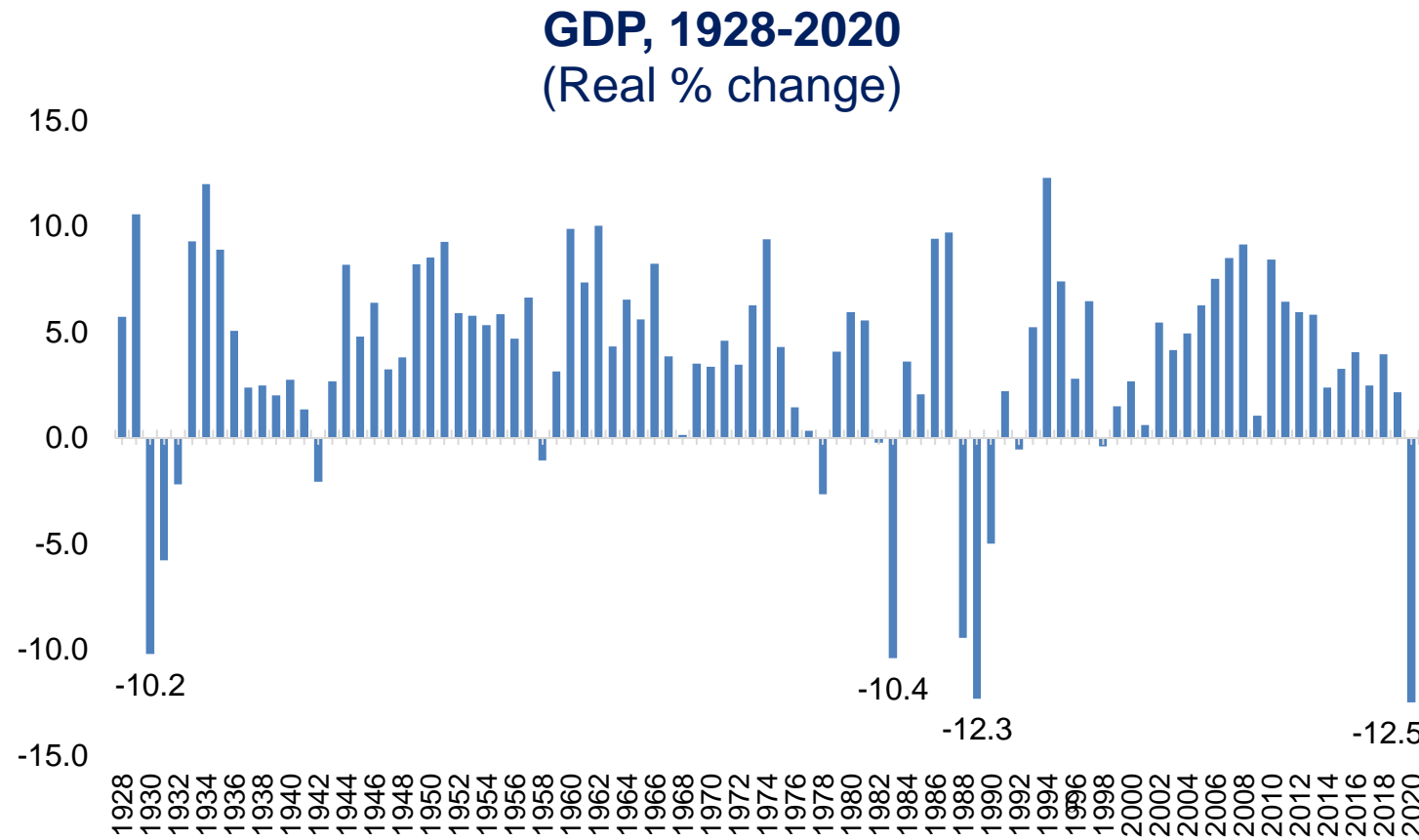
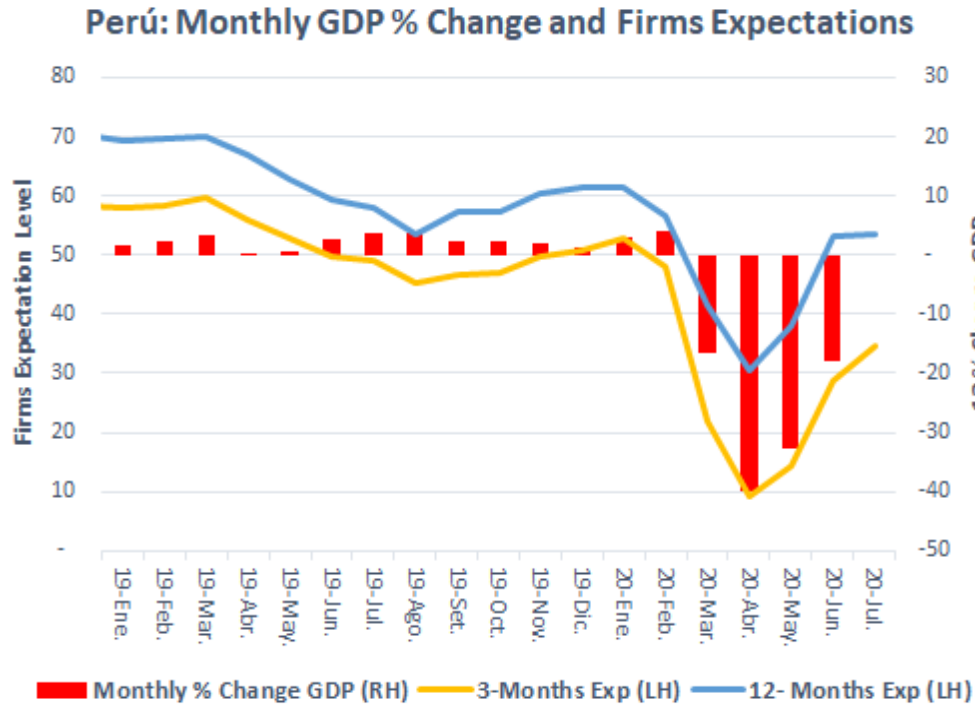
# Risk aversion triggered capital outflows in March. In July capital flows started to return to Emerging Market Economies.

## Capital Flows in dedicated funds to Emerging Markets( Stocks and Bonds)



Fuente: Barclays.

# COVID-19 also affected negatively GDP. Peru's GDP is expected to fall by 12.5% in 2020, the largest drop in the last 100 years.



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# To be effective, the BCRP response needed to be fast, big and as broad as possible.

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## Reduction of policy rate to historical minimum

Reduction of the policy rate between March and April, from 2.25% to 0.25%, its historical minimum.

Forward guidance: The BCRP Board of Directors has emphasized that they consider it appropriate to maintain a strongly expansionary monetary stance for a prolonged period and will expand monetary stimulus under different modalities.

02

## Easing of reserve requirements

Reduction of the reserve requirement in soles from 5% to 4% and of reserve requirement on FX external liabilities with terms below two years from 50% to 9%.

Reduction of banks' minimum current account requirement in soles with the BCRP from 1.0% to 0.75%.

Suspension of the additional reserve requirement associated with dollar loans.

03

## Financial system liquidity

Repos up to 3 years (securities and FX).

Easing of portfolio repos (new scheme includes factoring, entities rated up to B +, reduction of minimum guarantee).

Discount window (elimination of limit on operations).

**New liquidity facilities:** (i) Repos under Government Loan Guarantee Program; (ii) Repos conditional on rescheduling of loan portfolios; and (iii) liquidity facility under Government Loan Portfolio Guarantee.

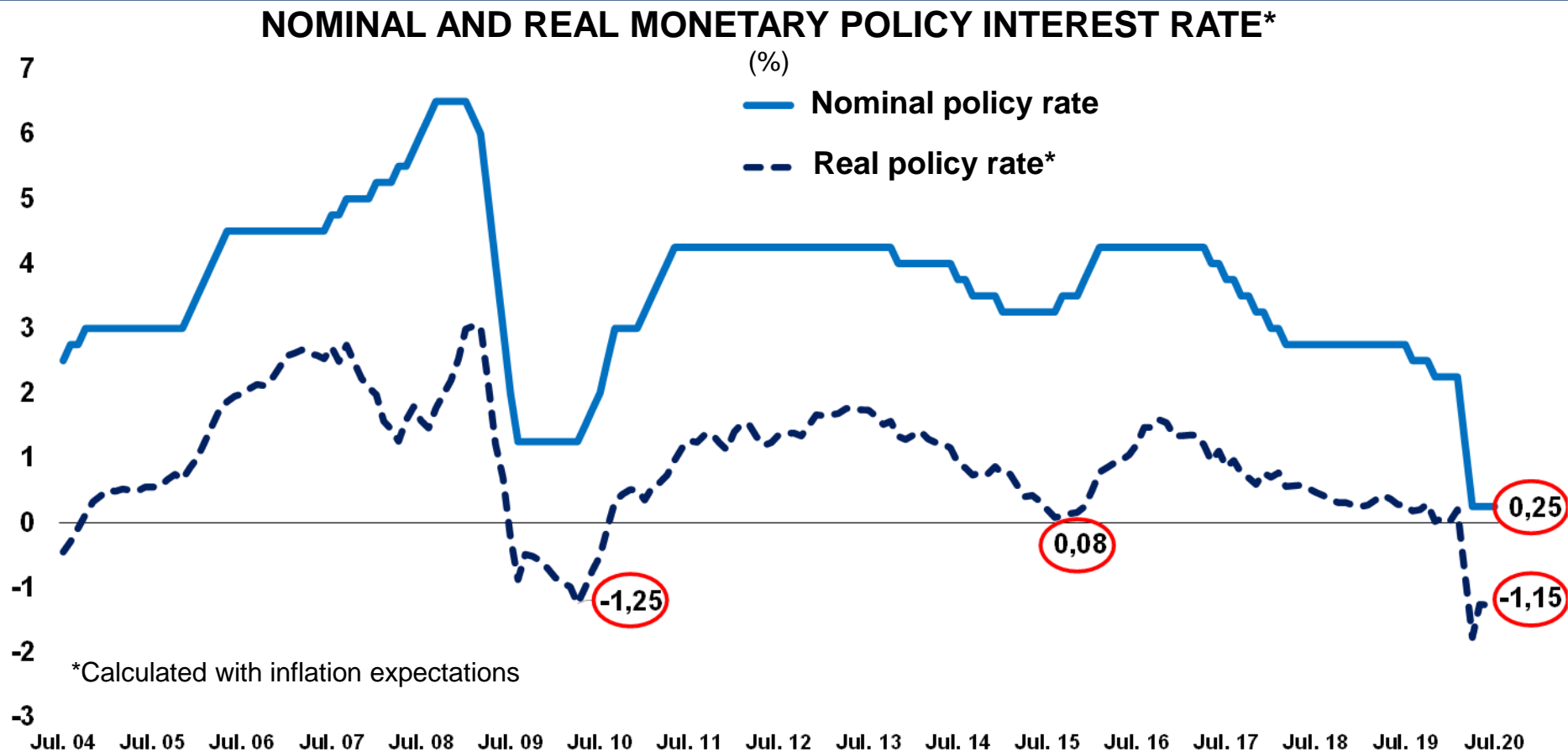
04

## Reduced volatility in long-term interest rates and the exchange rate

FX intervention mainly through derivatives (maximum balance of FX swap sales since the beginning of the state of emergency: maximum balance US\$ 2,3 billion on April 15).



# Conventional monetary policy: the BCRP reduced its policy interest rate to 0.25%, its historical minimum and performed massive liquidity injection operations.

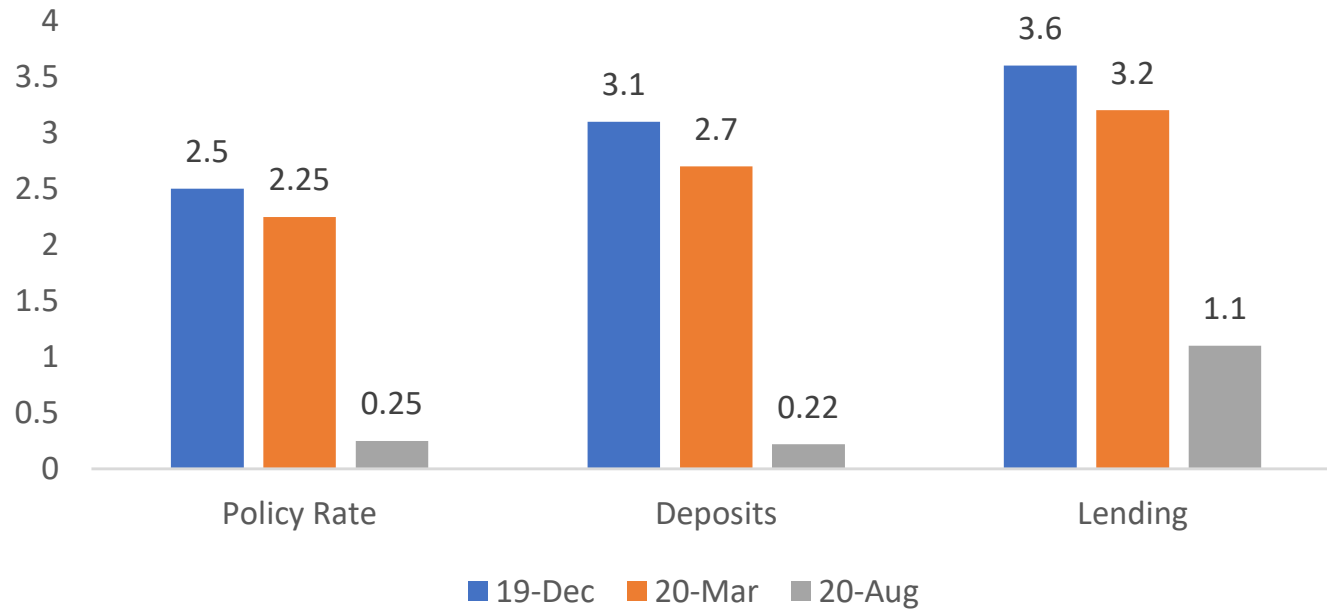


	Dec.16	Apr.17	May.17	Jul.17	Sep.17	Nov.17	Dec.17	Jan.18	Mar.18	Aug.19	Nov.19	Feb.20	Mar.20	Apr.20	May.20	Jun.20	Jul.20
(I) Nominal rate	4,25	4,25	4,00	3,75	3,50	3,25	3,25	3,00	2,75	2,50	2,25	2,25	2,25	1,25	0,25	0,25	0,25
(II) Inflation expectations	2,91	3,00	3,05	2,89	2,73	2,66	2,48	2,30	2,19	2,32	2,23	2,05	2,03	2,02	1,51	1,52	1,40
(III) Real rate (I-II)	1,34	1,25	0,95	0,86	0,77	0,59	0,77	0,70	0,56	0,18	0,02	0,20	0,22	-0,77	-1,26	-1,27	-1,15

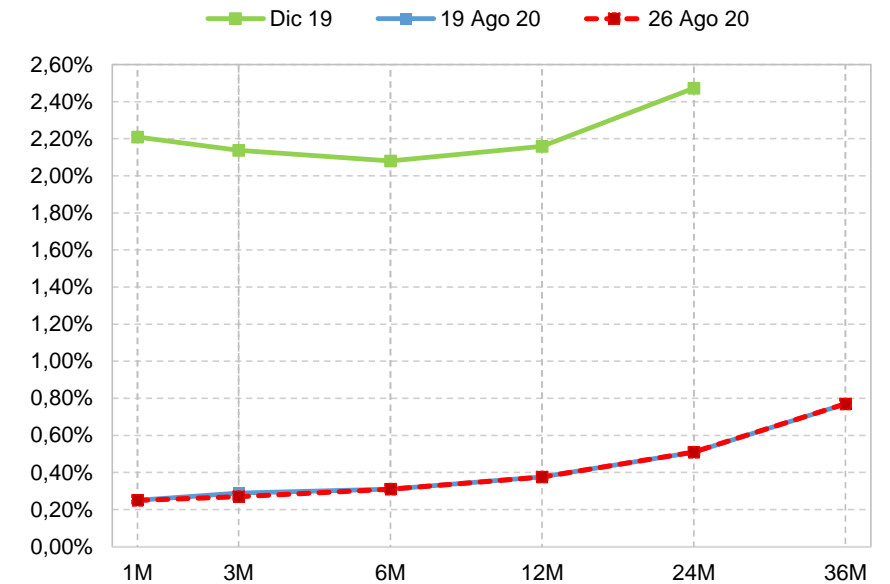
Source: BCRP.

# Money market interest rate declined in line with policy rates, easing credit conditions.

## Peru's Money Market Interest rates In %

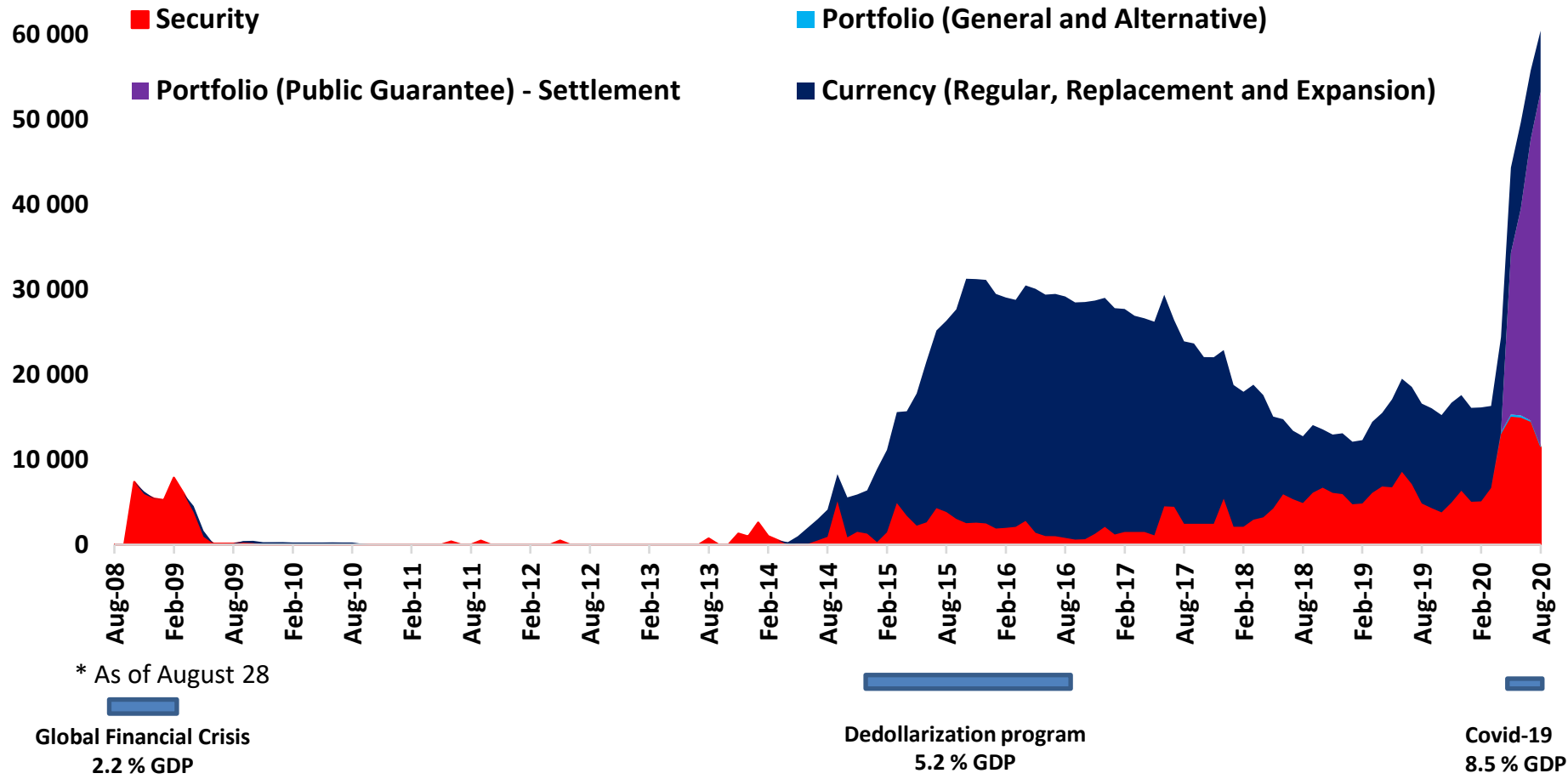


## CDBCRP Yield Curve



# Non-conventional instruments: Massive injection of term liquidity through a range of monetary instruments, including loan repos, and repos under the Government Loan Guarantee (GLG) Program

**BALANCE OF REPO OPERATIONS\***  
(Million of S/)

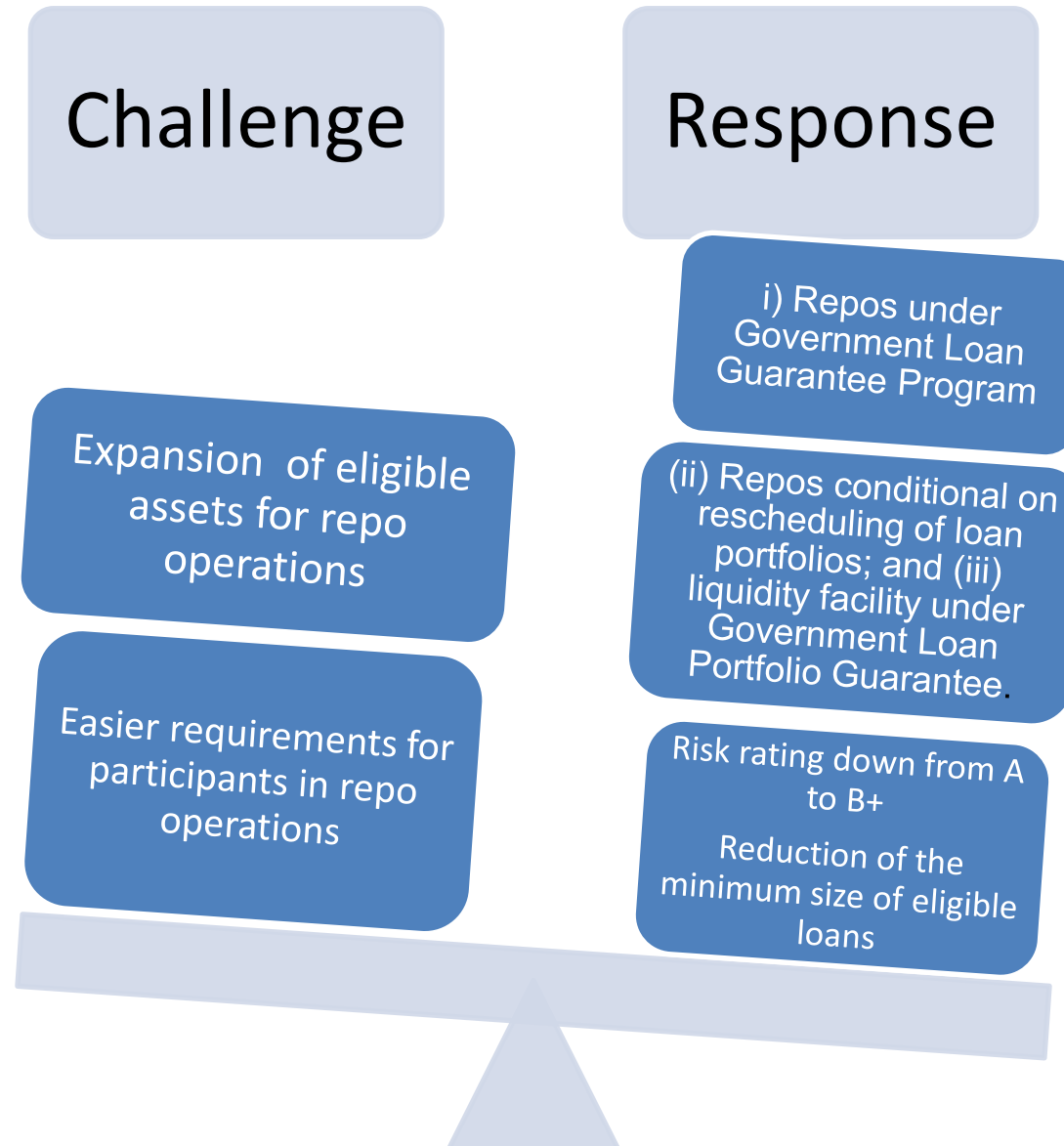


# Implementing these policy actions, poses several challenges

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1. Concentration of high quality assets in large banks. Reduces the effectiveness of standard repo operations with HQA as liquidity injection may not reach a large number of financial institutions.
2. Concentration of loans portfolios on consumer and SME loans, which reduces the amounts of liquidity they can obtain through loan portfolios repo operations with BCRP.
3. Limits to purchase Government bonds. BCRP is prohibit of purchasing Treasury bonds, which precludes the possibility of using standard QE policies.
4. Lack of development in capital markets, reduces the possibilities for the central bank to increase liquidity purchasing private sector securities

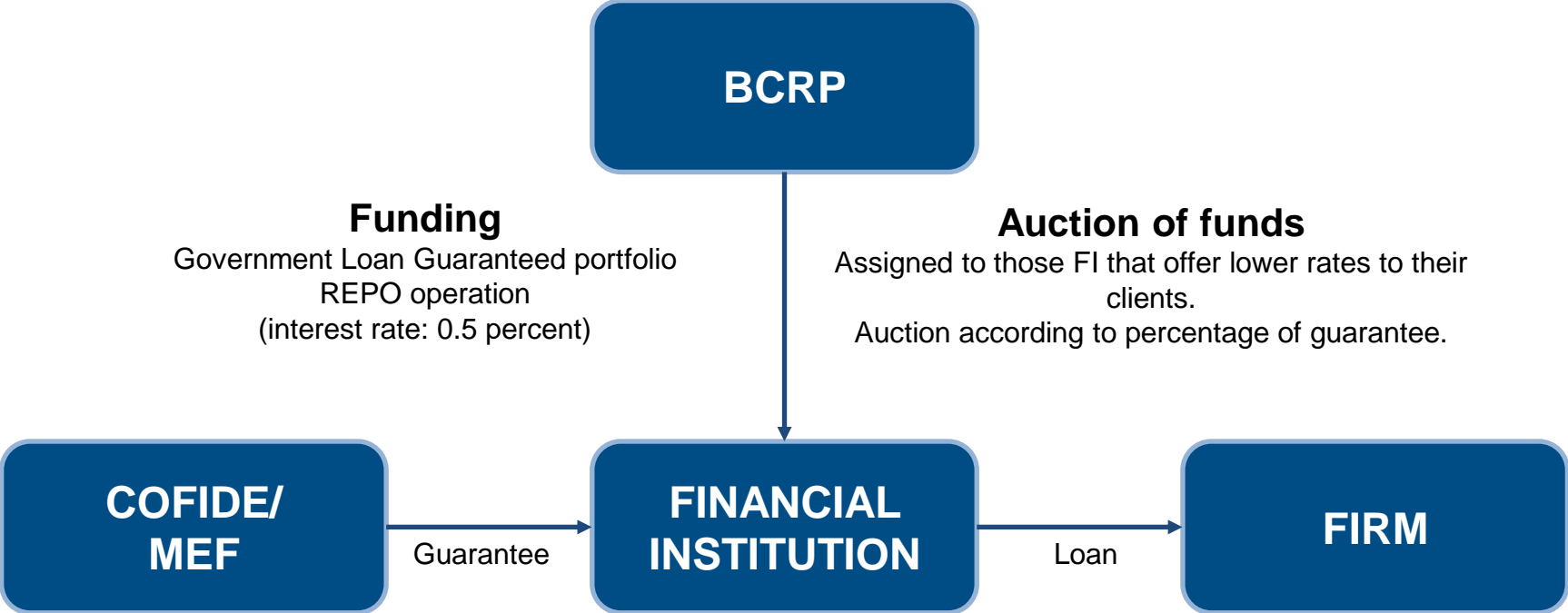
# In order to overcome these challenges, BCRP increased the set of instruments to inject liquidity.



# New liquidity injection instrument: Repo operations under the GLG Program

**Objective:** injecting liquidity quickly, so that companies can restock their working capital and pay their workers and suppliers, thereby ensuring continuity of the payment chain. **First tranche:** up to PEN 30 billion. **Second tranche:** up to PEN 60 billion (started on June 30). Altogether 8.4% of GDP.

## Flow of funds – Government Loan Guarantee Program



The auction mechanism contributes to accelerating the pass-through from the reduction of the BCRP policy rate to other interest rates.

## Loan Guarantee Program Auctions

Auctions under phase two of the GLG Program began on June 30. The first seven auctions amounted to PEN 20.6 billion (PEN 50.6 in total considering phase one), with a larger participation of SMEs.

### Repo Operations Auctions with Government Guarantee - Reactiva Perú

Guarantee Percentage	Interest Rates for Clients			Allocated Funds* (%)
	Minimum	Maximum	Average	
80	0,79	1,49	1,12	18,2
90	0,90	2,00	1,15	44,6
95	0,54	2,50	1,23	25,0
98	0,50	4,00	2,39	12,2
<b>Total</b>	<b>0,50</b>	<b>4,00</b>	<b>1,32</b>	<b>100</b>

\* As of July 21. Considers auctions under phases 1 and 2 of the GLG Program (PEN 50,6 billion).

**The BCRP influences the credit yield curve directly via repo auctions.**

## Lending rates decreased as a result of BCRP reference rate cuts, the significant increase in liquidity, and the GLG Program.

### LENDING RATES IN DOMESTIC CURRENCY <sup>1/</sup>

	Tasas		Historical average	Accumulated variation with respect to February
	Feb-20	Jun-20		
BCRP reference rate	2,25	0,25	3,52	-2,00
Corporate	3,40	3,03	5,26	-0,37
Big companies	6,09	2,56	6,85	-3,53
Medium enterprises	9,57	3,86	10,21	-5,71
Small enterprises	18,27	4,29	20,77	-13,98
Micro enterprises	31,36	3,79	33,10	-27,57

1/ Lending rates in annual terms of the operations carried out in the last 30 days (flow)

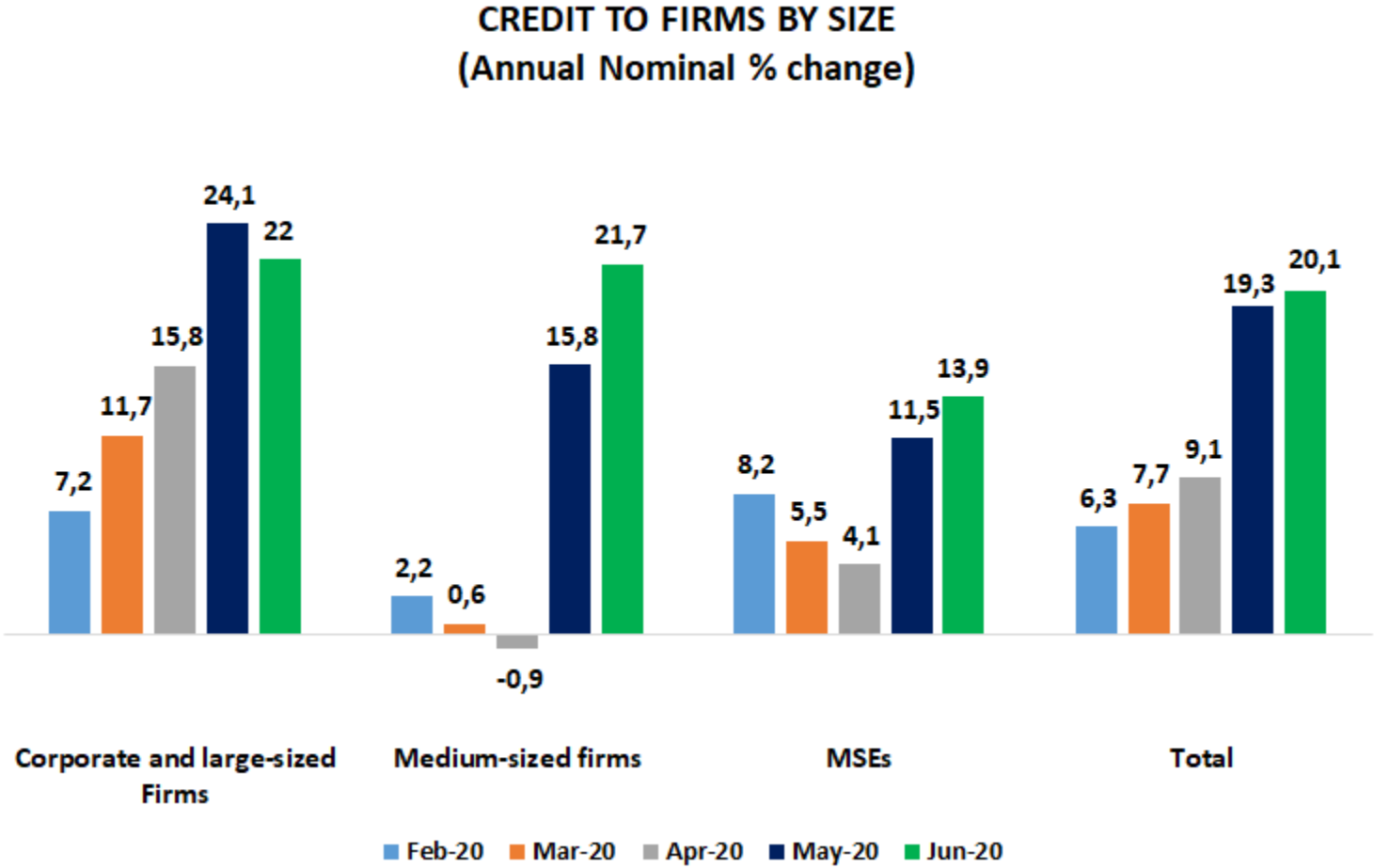
\* Information as of June 30, 2020

Source: SBS y BCRP

**Interest rates for micro and SMEs have fallen well below their historical levels under the GLG Program.**



Monetary policies have contributed to increasing credit to the private sector: 13.3% yoy in June (firms 20.1%). Without the GLG Program, credit to firms would have grew only 5.5% in June.



Source: BCRP

## New instrument: Repo operations conditional on loan rescheduling

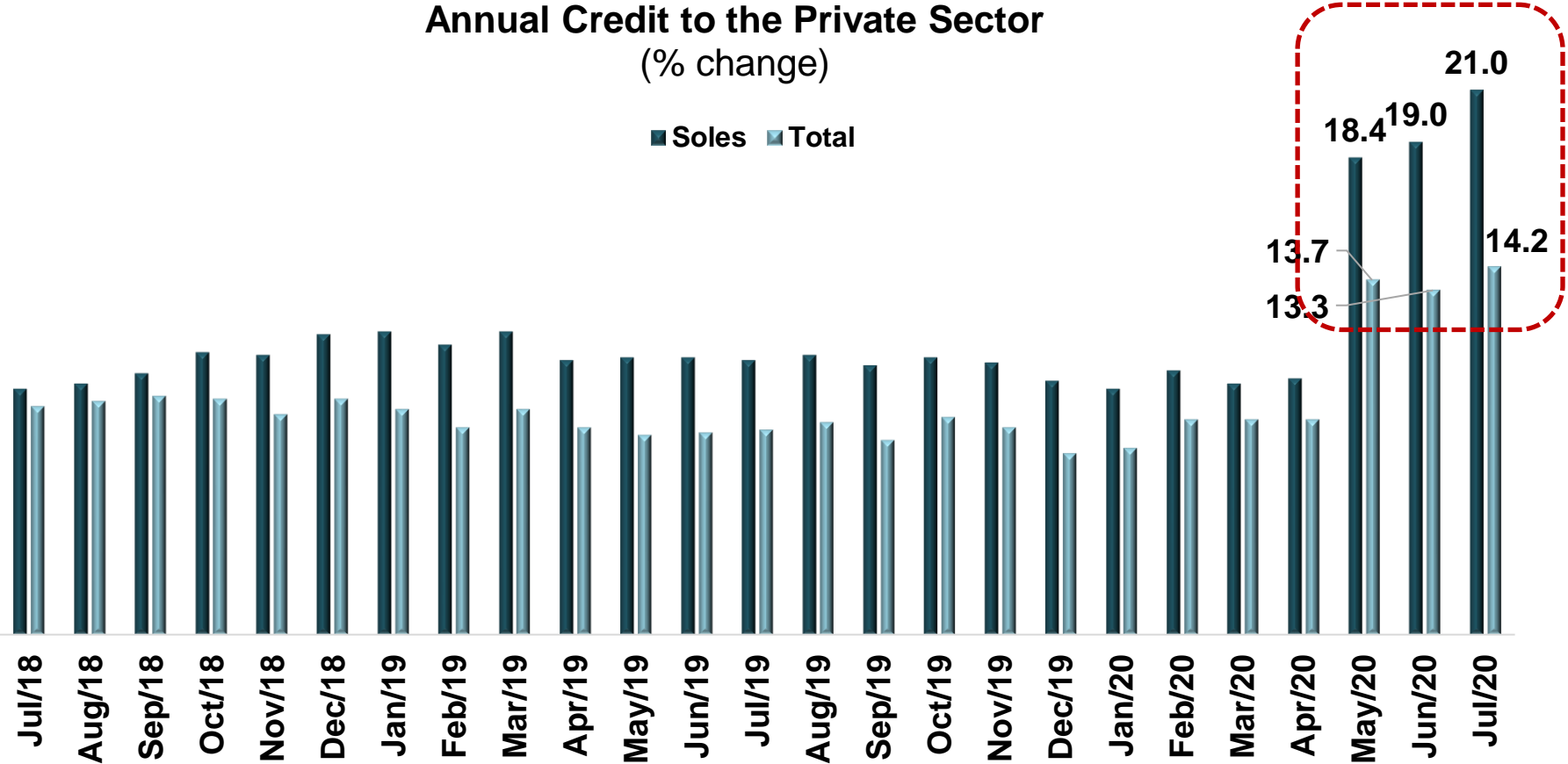
- Access to repo window conditional to rescheduling loans within 6-48 months at lower interest rates.
- **Objective:** promote coordination between financial institutions to reduce interest rates, providing long-term funding conditional on loan rescheduling.
- **Eligible collateral:** premium securities (DCs or Treasury bonds), FX (in USD), or loan portfolios.
- These operations are direct placements and are accessed voluntarily.



\* High quality securities, USD, or credit certificates.

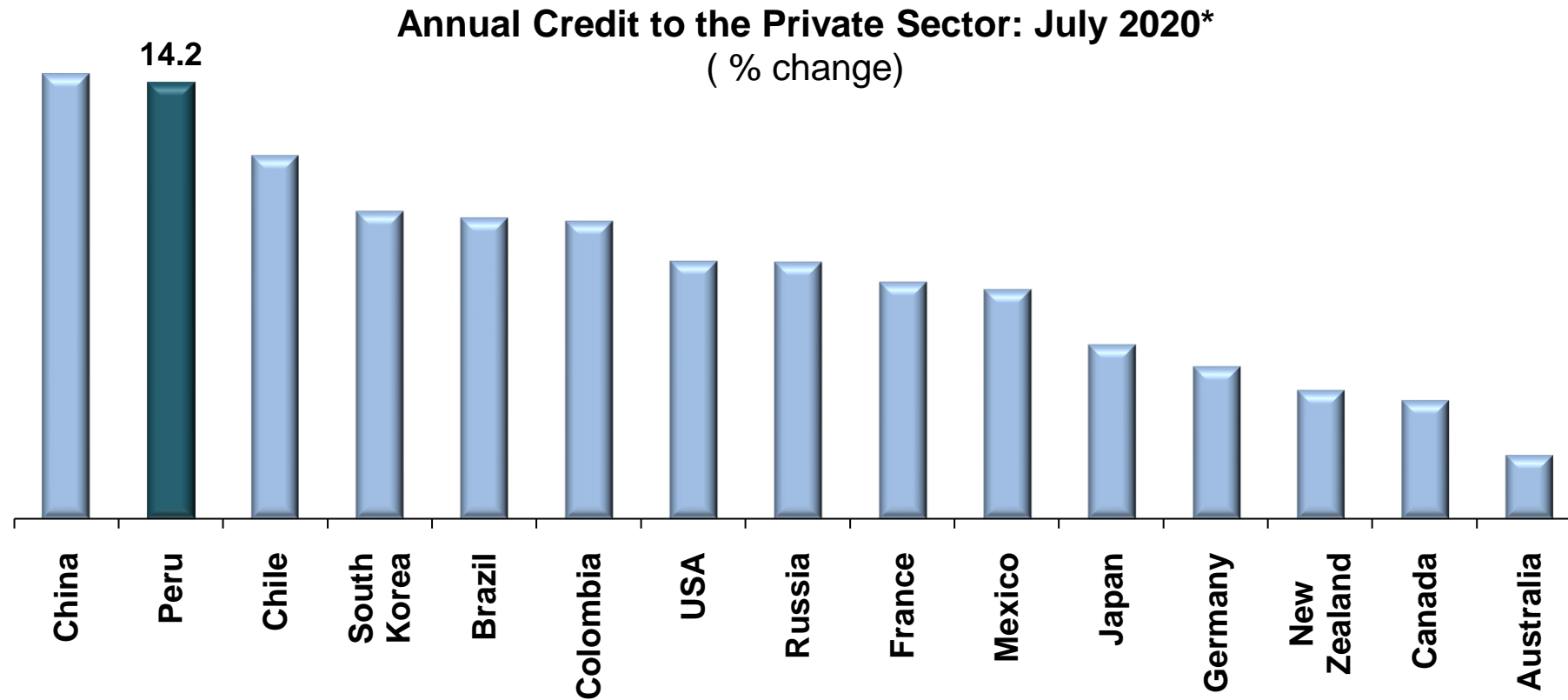
**The first operations were carried out on July 15.**

# Liquidity injection through BCRP operations allowed for counter-cyclical credit growth.



1/As of August 28  
Source: SBS.

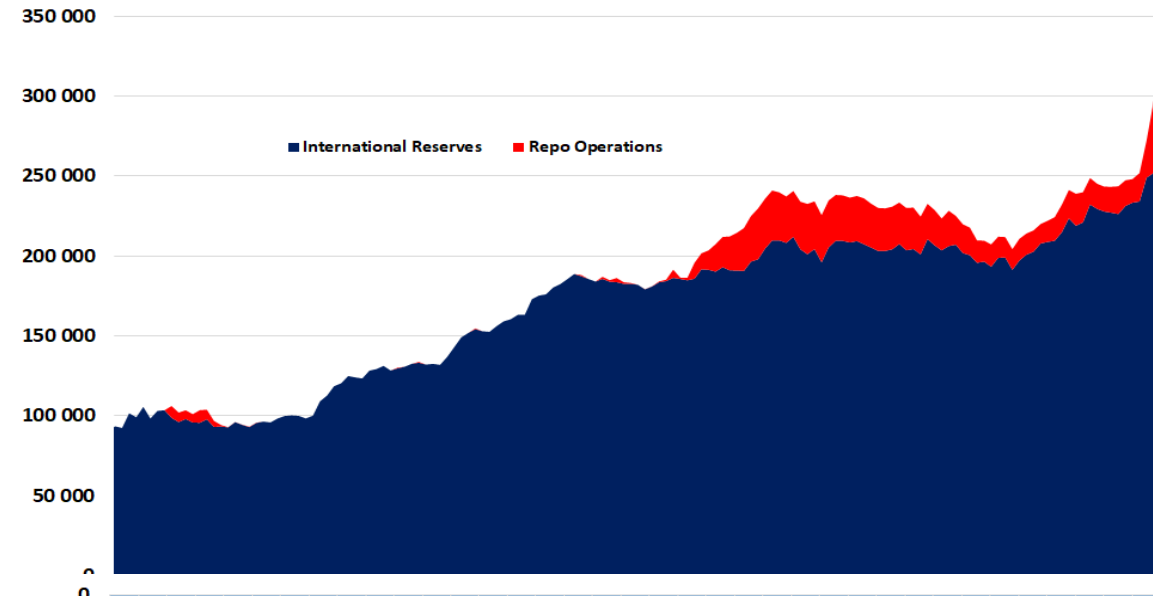
Credit to the private sector expanded by 14.2 percent in July 2020. This is one of the highest growth rates among developed and emerging countries.



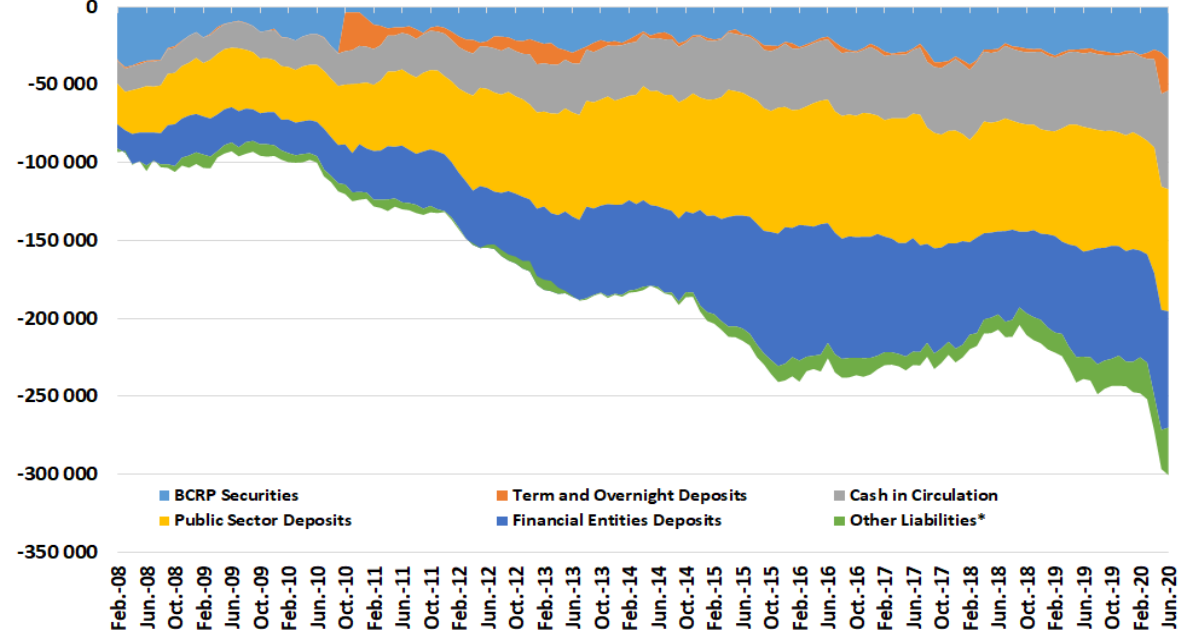
\*Peru as of July 2020; the rest of the countries as of June 2020, except Mexico, Japan and Canada as of May 2020.  
Source: Central Banks

# As a result of these operations, the BCRP's Balance Sheet amounts to S/ 301 billion (42 percent of GDP), its historical maximum.

**Total Assets  
(in PEN Million)**



**Total Liabilities  
(in PEN Million)**



# The massive injection of liquidity, equivalent to 9,6 % of GDP was effective in reducing the impact of the shock in the financial system.

## BCRP OPERATIONS

Flows (millions of S/)

Instruments	16 Mar. – Jul.*
1. Net BCRP Injection	<u>9 128</u>
a. Non-Guaranteed Repos	8 807
b. CD BCRP expiration	-2 997
c. Reduction in reserve requirements	2 000
2. GLG Program REPOS	<u>60 000</u>
<b>Total</b>	<b>67 810</b>
Note: Total in % GDP	<b>9.6</b>

\*As of July 20.  
Source: BCRP.

## Comparative of Monetary Aggregates \*

Country	YoY change	Last available
Australia	7.8	May 20
Brazil	23.2	May 20
Canada	14.9	May 20
Chile	9.5	Jun 20
China**	11.1	Jun 20
Colombia	17.6	Jun 20
South Korea	8.4	Apr 20
United States of America	23.1	May 20
Eurozone	9.1	May 20
Japan	5,9	Jun 20
Mexico	13.6	May 20
New Zealand	9.8	May 20
<b>Peru</b>	<b>21.8</b>	Jun 20
Russian Federation	11.3	Jun 20

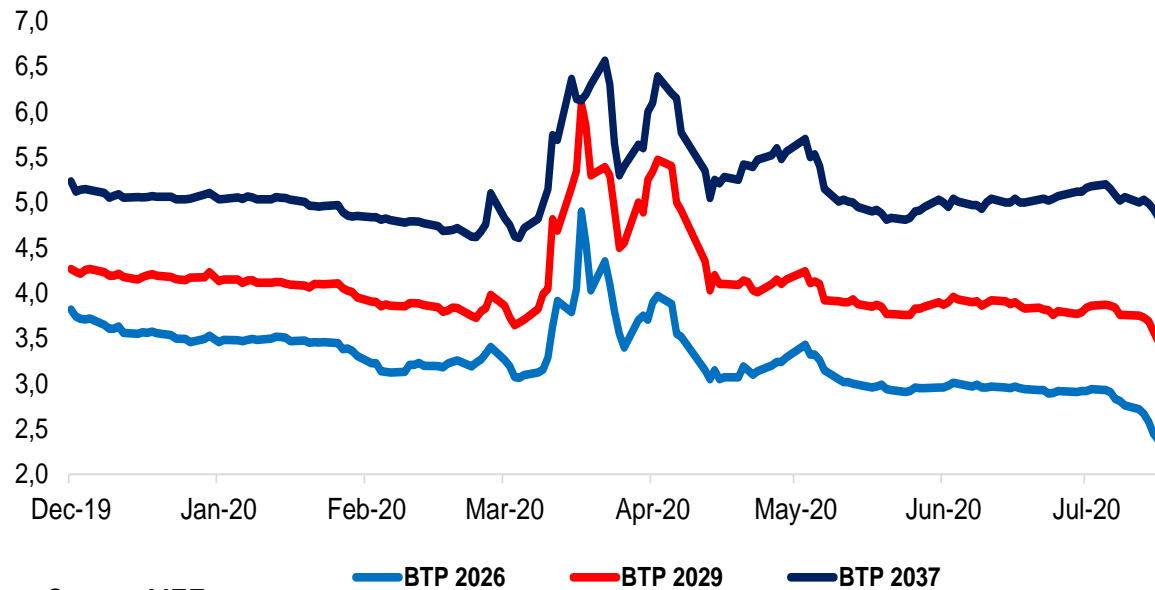
\* Corresponds to the definition of M3

\*\* Corresponds to the definition of M2

Source: IMF, Central Banks and FRED Database

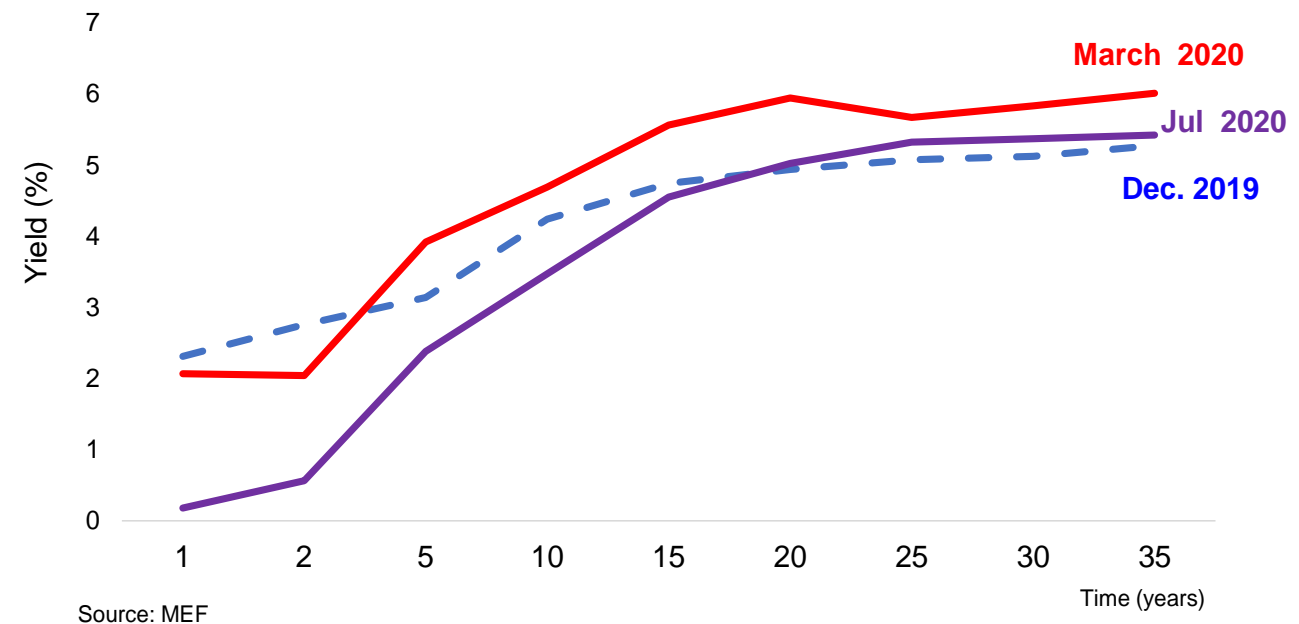
# Term Premium: Liquidity policy to impact the slope of yield curve by reducing medium- and long-term interest rates. . The 10-year bond is at its record low since 2005 (3.47%)

### Government Bonds Yields



Source: MEF

### Peru: Yield Curve of Sovereign Bonds



Source: MEF

Additionally, the BCRP has authorized pension funds (AFPs) to carry out repo operations using Treasury Bonds (BTPs), which contributed to reducing the volatility of BTP returns in response to the congressional authorization to withdraw 25% from pension funds.

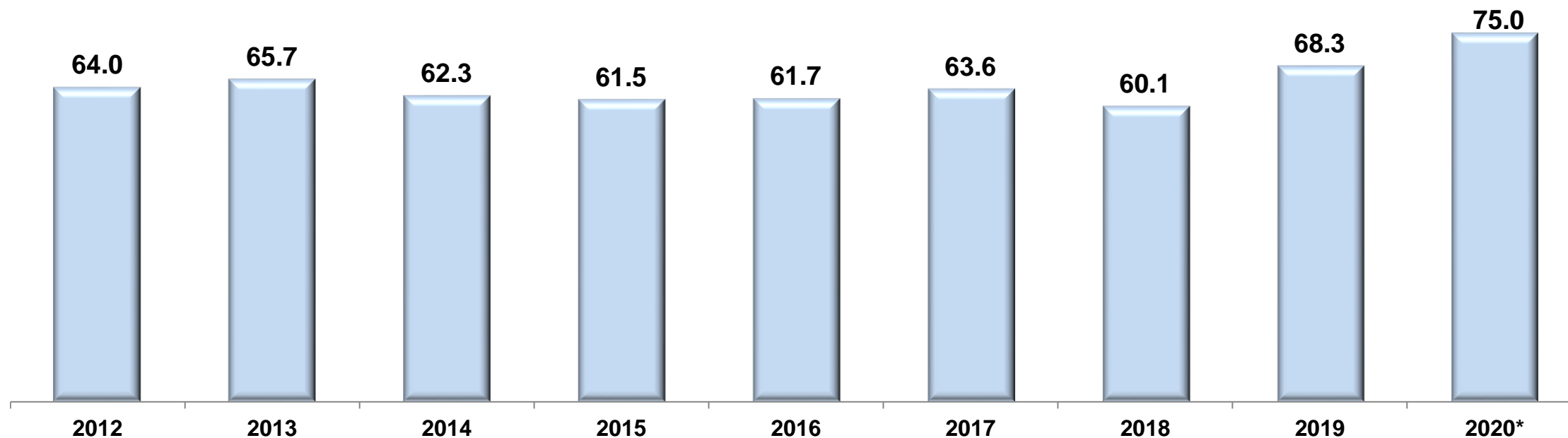
Peru's external position is strong due to a considerable FX reserve buffer; and has been reinforced by a precautionary USD 11-billion Flexible Credit Line (FCL) agreed with the IMF.

**Net International Reserves (NIR)**  
(USD Billions)

NIR (As % of:)	2018	2019	2020 <sup>2/</sup>
a) GDP	26.7	29.6	32.2
b) Short-term external debt <sup>1/</sup>	466	579	578
c) Short-term external debt plus current account deficit	360	446	468

<sup>1/</sup> Includes short-term debt balance plus redemptions (1-year) of private and public sectors.

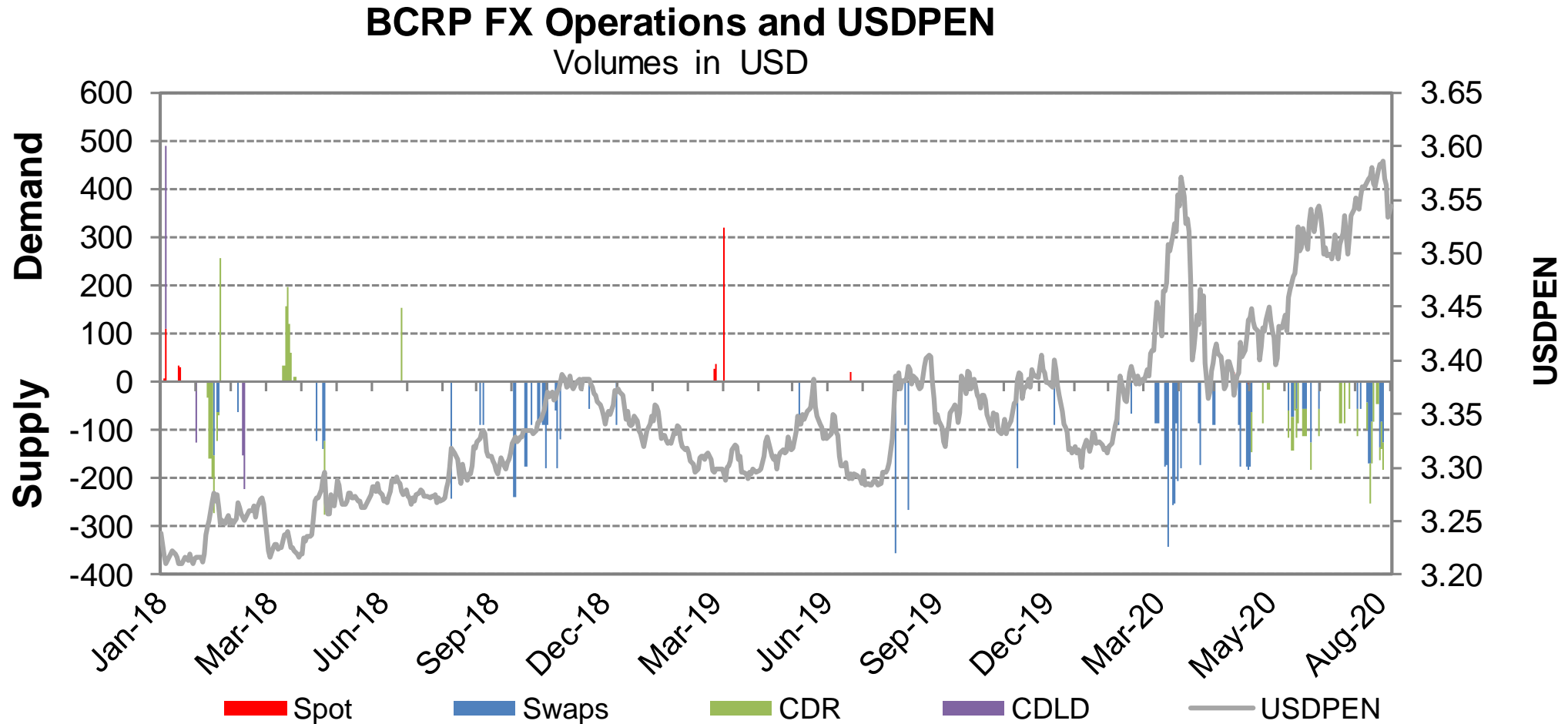
<sup>2/</sup> Forecast



\* As of July 20.  
Source: BCRP.



# To reduce FX volatility, BCRP has intervened in the Fx market using mostly CDR and Swaps.



Source: BCRP

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# Challenges Ahead

- 1. In order to accommodate the income shock, households and firms need long-term financing, which depends on financial entities' knowledge of their clients.**
- 2. The rescheduling program has contributed to offsetting the impact on the strength of the financial system.**
- 3. Maintaining the policy rate at ZBL entails risks, as the PEN is not a reserve currency. However, high FX reserves and the FCL act as a buffer in case of pressures on the PEN.**
- 4. Credit growth is currently supported by the loan guarantee program. Additional stimulus measures may be necessary later.**
- 5. How to achieve a smooth monetary policy transition when market conditions normalize?**